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MONTANA LEGISLATIVE HISTORY

November Special Session

Chapter 9 1993

Bill H _____ S 18 Original bill & history ____C

H. Committee on Taxation		S. Committee on Taxation	
Hearing Date(s) Dec 10	✓C	Hearing Date(s) Dec 02	✓C
_____	____C	Dec 03	✓C
_____	____C	_____	____C
_____	____C	_____	____C
Date Out _____	____C		

Did this bill originate in an interim committee? ____Yes ____No

Committee _____ Report _____

CHAPTER NUMBER 6
EFFECTIVE DATE: 07/01/94

SB 15 INTRODUCED BY JERGESON, ET AL.

GENERALLY REVISE THE LAW AND PENALTIES RELATING TO THE DAYTIME FUEL CONSERVATION SPEED LIMIT; PROVIDE FOR COUPON BOOKS THAT MAY BE PURCHASED IN ADVANCE BY MOTORISTS TO BE USED FOR FORFEITURE OF BOND FOR VIOLATIONS OF THE DAYTIME FUEL CONSERVATION SPEED LIMIT

11/30	INTRODUCED		
11/30	REFERRED TO FINANCE & CLAIMS		
11/30	FIRST READING		
11/30	FISCAL NOTE REQUESTED		
12/02	FISCAL NOTE RECEIVED		
12/03	FISCAL NOTE PRINTED		
12/03	HEARING		
12/03	TABLED IN COMMITTEE		

SB 16 INTRODUCED BY BURNETT, ET AL.

ELIMINATE THE STATE MEAT AND POULTRY INSPECTION PROGRAM

11/30	INTRODUCED		
11/30	REFERRED TO FINANCE & CLAIMS		
11/30	FIRST READING		
11/30	FISCAL NOTE REQUESTED		
12/01	FISCAL NOTE RECEIVED		
12/01	FISCAL NOTE PRINTED		
12/03	HEARING		
12/03	TABLED IN COMMITTEE		

SB 17 INTRODUCED BY CRIPPEN, ET AL.

PROPOSED CONSTITUTIONAL AMENDMENT TO ALLOW THE VALUATION OF PROPERTY FOR TAXATION TO BE BASED UPON ACQUISITION VALUE

BY REQUEST OF GOVERNOR

11/30	INTRODUCED		
11/30	REFERRED TO TAXATION		
11/30	FIRST READING		
12/06	HEARING		
	DIED IN COMMITTEE		

SB 18 INTRODUCED BY HALLIGAN, ET AL.

PROVIDE TAX INCENTIVES FOR INCREMENTAL OIL PRODUCTION FROM ENHANCED RECOVERY PROJECTS WHEN CERTAIN CRITERIA ARE MET

11/30	INTRODUCED		
11/30	REFERRED TO TAXATION		
11/30	FIRST READING		
11/30	FISCAL NOTE REQUESTED		
12/02	HEARING		
12/02	FISCAL NOTE RECEIVED		
12/02	FISCAL NOTE PRINTED		
12/04	COMMITTEE REPORT—BILL PASSED AS AMENDED		
12/06	2ND READING PASSED	41	9
12/06	3RD READING PASSED	41	9
	TRANSMITTED TO HOUSE		
12/07	FIRST READING		
12/07	REFERRED TO TAXATION		
12/10	HEARING		
12/11	COMMITTEE REPORT—BILL CONCURRED AS AMENDED		

12/11	2ND READING CONCURRED	80	18
12/11	3RD READING CONCURRED	83	16
	RETURNED TO SENATE WITH AMENDMENTS		
12/14	2ND READING AMENDMENTS CONCURRED	50	0
12/14	3RD READING AMENDMENTS CONCURRED	46	4
12/16	SIGNED BY PRESIDENT		
12/16	SIGNED BY SPEAKER		
12/17	TRANSMITTED TO GOVERNOR		
12/17	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 9		
	EFFECTIVE DATE: 12/17/93		

SB 19 INTRODUCED BY SWIFT, ET AL.

ELIMINATE THE RETIREMENT ADJUSTMENT FOR STATE, SCHOOL, AND LOCAL RETIREES, THUS EQUALIZING STATE TREATMENT OF THOSE RETIREES AND FEDERAL RETIREES

11/30	INTRODUCED
11/30	REFERRED TO TAXATION
11/30	FIRST READING
11/30	FISCAL NOTE REQUESTED
12/01	FISCAL NOTE RECEIVED
12/01	FISCAL NOTE PRINTED
12/08	HEARING
	DIED IN COMMITTEE

SB 20 INTRODUCED BY HARP, ET AL.

IMPLEMENT A PROPOSED CONSTITUTIONAL AMENDMENT ON PROPERTY TAX ADMINISTRATION THAT WOULD ALLOW THE VALUATION OF PROPERTY BASED UPON ACQUISITION VALUE

BY REQUEST OF GOVERNOR

11/30	INTRODUCED
11/30	REFERRED TO TAXATION
11/30	FIRST READING
11/30	FISCAL NOTE REQUESTED
12/06	HEARING
12/08	FISCAL NOTE RECEIVED
12/08	FISCAL NOTE PRINTED
	DIED IN COMMITTEE

SB 21 INTRODUCED BY TOWE

LIMIT THE INCREASE IN THE ASSESSED VALUE OF ELIGIBLE OWNER-OCCUPIED RESIDENTIAL PROPERTY TO THE PERCENTAGE OF THE STATEWIDE AVERAGE INCREASE IN ASSESSED VALUE

12/01	INTRODUCED
12/01	REFERRED TO TAXATION
12/01	FISCAL NOTE REQUESTED
12/01	FIRST READING
12/07	HEARING
12/07	FISCAL NOTE RECEIVED
12/07	FISCAL NOTE PRINTED
	DIED IN COMMITTEE

STATE OF MONTANA - FISCAL NOTE
Form BD-15
In compliance with a written request, there is hereby submitted a Fiscal Note for SB0018, as introduced.

ESCRIPTION OF PROPOSED LEGISLATION:

n act providing reduced net proceeds tax rates and reduced severance tax rates on the incremental production of oil from nhanced recovery projects that begin after December 31, 1993, and before January 1, 2003; exempting from net proceeds axation for a period of 18 months the production of oil from horizontally completed wells; requiring that the Board of Oil nd Gas Conservation approve enhanced recovery projects in order for the projects to qualify for the reduced tax rates; and roviding for an immediate effective date and an applicability date.

SSUMPTIONS:

. The data necessary to determine the impact of the proposed legislation is not available (MDOR).

ISCAL IMPACT:

xpenditures:

he proposed legislation will not have a significant impact on Department expenditures.

evenues:

et proceeds and severance tax revenues from *existing production* will not be impacted by the proposed legislation.

FFECT ON LOCAL REVENUES:

he local government impact from net proceeds tax revenues cannot be determined given the available information.

ONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

mpacts to future revenues will depend upon the amount of new production resulting from the proposed tax incentives.

ECHNICAL NOTE:

he title of the bill states that oil production from horizontal wells is exempt from the net proceeds tax for the first 18 onths of production. The proposed legislation exempts both oil *and* natural gas production from the net proceeds tax for he first 18 months of production from horizontally drilled wells.

Dave Lewis 12-1
DAVE LEWIS, BUDGET DIRECTOR DATE
Office of Budget and Program Planning

MIKE HALLIGAN, PRIMARY SPONSOR DATE
Fiscal Note for SB0018, as introduced

SB 18

Opponents' Testimony:

None.

Questions From Committee Members and Responses:

None.

Closing by Sponsor:

Senator Towe closed the hearing on SB 4.

EXECUTIVE ACTION ON SB 4

Motion/Vote:

Senator Towe MOVED TO AMEND SB 4 (Exhibit #2). The MOTION CARRIED UNANIMOUSLY.

Motion/Vote:

Senator Towe MOVED SB 4 DO PASS AS AMENDED. The MOTION CARRIED UNANIMOUSLY.

HEARING ON SB 18

Before opening the hearing on SB 18, **Chair Halligan** turned the Committee over to **Vice-Chair Eck** who established an 80 minute limit for testimony presented on SB 18. She stated the time would be equally divided between opponents and proponents.

Opening Statement by Sponsor:

Senator Halligan, Senate District 29, said his attendance at the recent National Conference of State Legislators (NCSL) and his experience on the Taxation Committee had caused his involvement with SB 18. He stated having witnessed the adoption of various incentives over the past 13 years and having those incentives placed in a national context by discussion at the NCSL made him realize it was time to reassess the tax incentives which Montana has granted to date. He explained that at the NCSL legislators from across the nation had expressed both their extreme displeasure that the current competition between states had created a condition of economic warfare between states and their extreme frustration with the relationship of cost and benefits the states actually receive as a result of some incentives.

According to **Senator Halligan,** week-long discussion and deliberation at the NCSL resulted in a general agreement about those elements of tax incentive policies which were most effective and which would reduce the possibility of unfair competition between states. He then sketched out five NCSL

criteria for tax incentives: 1. General tax incentives do not work but targeted incentives do; 2. Incentives should not be given for activity already taking place; 3. In order to achieve a "level playing field" for existing businesses, environmental or other regulatory breaks should not be given to industry; 4. So that their effectiveness can be periodically evaluated, incentive policies should incorporate strict audit requirements and require legislative review; and 5. Incentives should be granted which provide jobs with higher than average weekly wages and health benefits, not retail and minimum wage positions.

Senator Halligan informed the Committee that SB 18 had been drafted in accordance with the NCSL criteria. He said the tax policy contained in SB 18 was specifically targeted to provide incentive for horizontal construction and secondary and tertiary production. He noted SB 18 would only provide incentives in those cases where new drilling, new economic investment, and new production occur. He added SB 18 would not grant any environmental or regulatory breaks to the oil industry. **Senator Halligan** stressed that very strict audit requirements including a sunset provision were built into SB 18. He stated the sunset provision would require that the incentives be legislatively review and their effectiveness judged. According to **Senator Halligan,** too many states have adopted incentives and never measured their effectiveness because neither the criteria nor the legislation necessary to effect such review were present. He noted that many of the jobs SB 18 would help to create would pay higher than average wages.

Senator Halligan admitted that SB 18 would require the Legislature to trust the oil industry to a certain extent. He emphasized, however, that SB 18 would establish stricter requirements with which the industry would have to comply. He distributed copies of the fiscal note for SB 18 (Exhibit #4) and informed the Committee that some technical adjustments would be necessary to SB 18 since natural gas had inadvertently been included in its body.

<u>Proponents' Testimony</u>:

Stan Kaleczyc, Helena Lawyer representing Meridian Oil Company, stated that Meridian Oil was a strong advocate of SB 18 and had representatives at the hearing primarily as resources for the Committee. He introduced the following Meridian representatives who could answer questions for committee members: **Perry Pearce, Director of State Governmental Relations; Bill Tulloch, Advelorem Tax Manager; Brent Smolik, Regional Engineer.**

Mr. Kaleczyc "briefly" reviewed the proposal contained in SB 18 to provide a common basis for the ensuing discussion. He informed the Committee that oil production and, given stabile oil prices, the revenue Montana receives from that production was currently declining at the annual rate of seven percent. He said since the discovery of a new major oil field in Montana was

unlikely, "the best way to slow down that decline rate is to provide incentives for new and more expensive technology", which SB 18 would do.

According to **Mr. Kaleczyc**, the incentives SB 18 would provide are two-fold: the current 12 month holiday from local net proceeds tax enjoyed by both horizontal and vertical drilling would be extended to 18 months for horizontal drilling only; and the state severance tax rate and local government severance or net proceeds tax rate, which ever applies to the well, would be reduced for new secondary and tertiary oil production. He explained that enhanced recovery projects have ongoing expenses and actually become more expensive the later into its life a project is. **Mr. Kaleczyc** emphasized that SB 18 demonstrated "sensitivity" to the current fiscal crisis in Montana and would have no impact on either current revenues or on future revenues from wells that have already been drilled. He assured the Committee that SB 18 provided an incentive only for "new dollars that are put into the ground": i.e., new production and new incremental production on secondary and tertiary projects. He distributed three handouts (Exhibits #5,#6, and #7) and alluded to the potential advantages Montana would receive if the incentives in SB 18 were adopted. According to **Mr. Kaleczyc,** Meridian and Shell Oil companies have proposed to drill 138 new wells at a cost of $140 million over the next five years. He noted that over the life of those wells, which in some instances will extend to 2032, Montana would receive approximately $122 million in revenue through state severance tax, royalty payments to the state and local government taxation.

Stan Kaleczyc identified and answered three questions about the effects of SB 18 which frequently came up in his discussions on the proposal. He said the first question dealt with the relationship of horizontal drilling, secondary and tertiary production, and the incentives contained in SB 18. **Mr. Kaleczyc** noted the answer was twofold and dependent upon the nature of the horizontal well. He explained, if the horizontal well is drilled for primary production, under SB 18 the only incentive connected to the production of that well would be an 18 month tax holiday, but if the horizontal well is drilled for enhancing secondary production, any incremental production resulting from that well would receive an 18 month holiday and thereafter be taxed at the incentive lower rates. **Mr. Kaleczyc** said the second question was "will this happen anyway without incentives?". He noted he could only answer that question for Meridian oil which has been conducting some pilot well activity in eastern Montana since 1988. He said even though Meridian knows there is oil in the ground, it has been unable to economically justify pursuing those production project on a larger scale, an unfortunate situation which SB 18 could possibly rectify. The third question **Mr. Kaleczyc** identified was "is SB 18 a sure thing?". He stated the oil industry was a risky business and three primary factors will affect the influence of SB 18 on industry: the price of oil, the production of the wells that are drilled, and the projects'

economics. According to **Mr. Kaleczyc**, the incentives contained in SB 18 would provide industry with a "little bit of cushion" to help ameliorate the up and down "blips" experienced with the price of oil over a typical year. He noted, however, SB 18 could do little to improve the situation if the wells do not produce. He said because of the tight economics on the projects Meridian has mapped out, SB 18's incentives are a significant component in making the projects economically justifiable.

Brent Smolik, Regional Engineer, Meridian Oil, Inc., said he was responsible for the planning and implementation of all oil and gas activity in the Rockies including those projects in Montana. He then spoke using prepared testimony (Exhibit #7). He emphasized that not only are horizontal wells two to three times more expensive to drill than horizontal wells, but the problems associated with horizontal wells are also about one-third more costly. He then outlined some of the projects Meridian anticipates in Montana in order to give the Committee a sense of their "marginal nature". **Mr. Smolik** urged the Committee to pass SB 18 because Meridian believed that the incentives contained therein would serve to induce new, significant capital spending in Montana and would ultimately result in increased production and increased revenues for the State without having any effect on current revenues.

Jerome Anderson, Helena Lawyer representing Shell Western Exploration and Production, Inc., introduced **Rich Hansen, Manager of External Affairs based in Houston** and **R.E. Sheffield, Western Asset Technical Manger for Shell Western E&P, Inc.**

R.E. Sheffield, Manager, Western Asset Technical Manager, Shell Wester E&P, Inc., spoke from written testimony and visuals (Exhibits #8a, and #8b). He stated he was responsible for the technical review and budget preparation for all projects that Shell Western E&P completes in Montana.

Gail Abercrombie, Executive Director, MPA, described the MPA membership as ranging from independent companies to the major corporations. She directed the Committee's attention to a packet of letters from numerous oil and gas producers with activities in Montana (Exhibit #9). She reviewed some statements in support of SB 18 contained in those letters.

David Johnson, President, MPA, spoke from written testimony in support of SB 18 (Exhibit #9a).

Bill Vaughey, introduced himself as a small independent explorer for oil and gas with offices in Havre the last 25 years. He informed the Committee he had served a 2.5 year term as MPA president in the "early 1980s". He said he was an enthusiastic proponent of SB 18 because he was convinced the incentives would work and Shell and Meridian would drill the wells they have tentatively scheduled for 1994 and beyond. He said he was convinced those wells would result in increased level of

production which would yield a higher amount of tax revenue for the State. He noted the State needs the money.

Speaking on behalf of the 31 counties which form the Montana Oil Gas and Coal Association (MOGCA), **Sue Olson, Musselshell County Commissioner and Chair, MOGCA Board,** expressed support for SB 18. She stated the counties have suffered through many years of decline in oil production and have seen the local government severance tax revenue shrink every year. She said SB 18 would promote increased oil activity in the counties and would be a major tax benefit both to local communities and to the State. She noted that horizontal drilling and secondary and tertiary recovery projects are expensive endeavors. She stated even though the incentives contained in SB 18 would reduce taxation on new production in order to help companies recover more of their costs, the counties "have only to gain from SB 18". According to **Ms. Olson**, "additional cost to the oil companies shows up as additional jobs in our counties, more property and income taxes being paid and increase in business in our communities". She also noted that enhanced recovery procedures help recover more oil from wells producing very little oil. Reducing the percentages, she said, would encourage oil companies to recover more oil in these fields instead of plugging the wells, bringing in additional revenues to the local communities and the state. **Ms. Olson** expressed the counties' concern that existing production might be reduced with the drilling of horizontal wells within an established field. She noted, however, that those concerns had been abated with the statement of intent contained in SB 18. She also stated that the counties expected to receive the same percentage of the incremental portion as they are currently receiving.

Dennis Iverson, Northern Montana Oil and Gas Association (NMOGA), explained that his was an organization in the Shelby and Cutbank area which was established primarily by small independent oil and gas producers. He stated, however, that a large percentage of NMOGA dues-paying members have nothing directly to do with the oil and gas industry but represent other businesses and interests in the area. He explained those people are involved in NMOGA because they not only realize that the economic impact of oil and gas in their respective areas is very important, but also recognize the importance of a diversified local economy and tax base. He stated virtually all sectors in the Shelby and Cutbank area support SB 18 "very strongly". **Mr. Iverson** noted that oil and gas are no longer as important a part of the revenue mix as it was in the late 1970s, but added that SB 18 "provides the opportunity to begin to recapture some of that market share and tax revenue" in a way that primarily involves existing oil fields and thereby makes good environmental policy. He stated SB 18 was "clearly good tax policy...[and] excellent public policy".

James Tutwiler, Montana Chamber of Commerce (MCC), and **Montana Taxpayers Association (MTA),** stated that both the associations he represented supported SB 18 because it clearly attached

incentives to project incentives and because it provided a fair and favorable way for business and the oil industry to be more competitive in Montana. He added that SB 18 had the potential to enhance state revenues, would provide incentives for an economic activity which would create secondary jobs, and would benefit everybody in Montana.

Rick Hill, Governor's Office, stated that Governor Racicot was an "enthusiastic supporter of SB 18" and believed that providing incentives for horizontal drilling will result in the regeneration of production, tax base and communities. He stated the plan contained in SB 18 "makes economic sense for Montana because it will create jobs and will also increase tax revenues". According to **Mr. Hill,** Governor Racicot believes that SB 18 is "a win-win proposal"; the taxpayers of Montana will win, the industry will win, and the people whose jobs will be created will win.

Senator Tveit, Senate District 11, said SB 18 was a "pretty positive piece of legislation" which contained no loopholes for industry. Because the incentives would apply only to new production, he stated SB 18 would represent no revenue loss to the counties. He also noted it was important to recognize the globality of the oil industry; the US imports over 50 percent of it oil and, according to **Senator Towe**, Montana and other states should be partners in bringing more oil revenue into the nation. He said SB 18 was a long-term approach and stated that it was time for Montana to start looking ahead into its future and the future of its educational system.

Rocky Gorder, Owner, B&G Roustabout Service, introduced himself as a 16 year resident of Sidney, Montana and said his company currently employs seven people in Montana and 12 in North Dakota. He stated he had seen the oil boom of the late 1970s and the subsequent rapid decline of oil production in Montana. He noted that 75 percent of his business had been in Montana and 25 percent in North Dakota during many of those years but currently only 35 percent of his business was in Montana. He stated those jobs are going to North Dakota; time after time he had seen companies choose to drill in North Dakota rather than in Montana. He stated the adoption of SB 18 would change that trend and provide for more jobs and more revenue for the state and counties.

Dave Cramer, Dave's Hot Oil Service, Sidney, said he once employed two people in addition to himself but since his business has declined about 50 percent in the last few years, he now did all the work. He noted he also served on the board of trustees at the Sidney school. He stated SB 18 would work and as a result help his business, the oil industry, and the school system as much as any other possible alternative.

John Pigg, HR.P. Oil Properties, introduced himself as a long-time independent land man in Richland County. He said many

changes have taken place since the end of the oil boom in 1981; many of his clients either were forced to merge with another company or went out of business, and over 450,000 people employed in the oil industry lost their jobs since 1981. He noted that those people who are still working have seen their salaries decrease while their workloads increase. He stated that SB 18 would create an increase in oil and gas activity and leasing, his business, which would generate income for land owners who spend most of their money in the local economies. He said it was necessary to show the industry that Montana wants to attract business and to be competitive with our neighboring states, a message that would be delivered by the incentives contained in SB 18. He expressed his believe that horizontal drilling would benefit Montana's entire economy as it had done in other producing states. He stated if Meridian and Shell were successful in drilling horizontal wells and increasing incremental production in secondary and tertiary projects, other companies would follow.

Peggy Trenk, Western Environmental Trade Association (WETA), said WETA supported SB 18 for all of the previously stated reasons. She added that WETA also viewed SB 18 as a means to create a partnership between local governments, the State, and industry to produce a necessary product and do so "while allowing industry to walk a little lighter on the land".

Robert Marquiss, Updike Brothers Wells Servicing Company, expressed his belief that SB 18 would help the oil industry. He stated Updikes had six oil-well servicing rigs in 1986, but currently have only four. He expressed his hope that new well production would allow the Updikes to expand again.

Senator Bruski-Maus, Senate District 12, noted her district encompasses Dawson, Fallon, Carter and Powder River counties which have all been suffering from economic decline ever since the oil bust. She stated SB 18 would benefit her district's economy, not only from taxes but also from increased business within the area. She concluded SB 18 was a win-win piece of legislation.

Everett Mitchell, Mitchell's Oil Field Service, Baker, Montana, said his company employs approximately 48 people out of Baker and Sidney and "is very much in favor of SB 18".

Gloria Paladichuk, Richland County Commissioner, stated that the **Board of Richland County Commissioners** would like to go on record as unanimously supporting SB 18.

Don Rieger, Chairman, Fallon County Commission, stated his county would be benefit from SB 18. He stated the Fallon County Commission also wanted to go on the record in support of SB 18.

Don Franz, President, Franz Construction, Inc, Sidney, Montana, said he owned an oil-servicing company. He expressed his strong

support for SB 18 and informed the Committee that 70 percent of his work was currently in North Dakota and 30 percent in Montana. He said much of his work in Montana was on the reclamation of plugged and abandoned wells, and noted SB 18 would make it possible for some of those wells to continue to produce oil.

Opponents' Testimony:

Representative David Ewer, House District 45, stated SB 18 was not appropriate legislation for a session in which significant cuts would be made in State support for human services and education. He asked the Committee to consider what the public's response would be if the Legislature gave a tax break to corporate oil while making those cuts which would seriously reduce vital services. He asked the Committee whether the proponents of SB 18 had presented any truly compelling reason why this issue could not wait for the next regular session.

Aside from questioning its appropriateness, **Representative Ewer** expressed concern about the provisions in SB 18. He stated that the historical record shows that tax incentives allowed by government to increase production in Montana clearly do not work. As examples he cited past State policy in the areas of coal, oil and canola oil. He argued that market price actually determines supply and demand, not Montana's tax policies. **Representative Ewer** noted that SB 18 did not demand any commitment from the oil companies even though the tax incentives it would grant were "iron-clad". He suggested that Montana should stop relying on faith and make part of the incentive package retroactive; let the oil companies "do their activity and when they have proven their record reimburse them some money". He stated he lent money for a living and always made sure that any contract he entered into had "iron-clad" guarantees on both sides. **Representative Ewer** also informed the Committee that an expert he had consulted acknowledged that these new improved methods of drilling oil may expedite the production of oil. He stated that conversation along with a letter received from the office of the North Dakota State Tax Commissioner made him concerned about the 18 month holiday SB 18 would grant for new horizontally drilled wells. He read from that letter that "approximately 60 percent of the [horizontally drilled] wells were low producers, (i.e., 10 barrels or less of average daily production) either initially or by the time the 15-month exempt period expired" .

Questions From Committee Members and Responses:

Senator Towe noted that much of the oil companies' testimony emphasized how the enactment of SB 18 would increase oil production, cause $141 million to be invested in the drilling of 138 new wells, and bring another $122 million to local communities in taxes and other benefits over the next 30 years. He stated that the local communities had been so informed and had obviously believed the oil companies since they had attended the hearing and spoken in support of SB 18. He said **Jerome Anderson**

had testified in 1985, that if the Legislature would give the oil companies a break on tertiary recovery, that action would result in major carbon dioxide (CO2) injections in eastern Montana which would be accompanies by large investments and new activity. **Senator Towe** asked **Mr. Anderson** how much new production and economic activity had actually resulted from the break on tertiary recovery which the Legislature granted in 1985.

Jerome Anderson responded that he specifically remembered the 1985 legislation and congratulated **Senator Towe** for supporting the measure. He explained that the proposed program consisted of a gasflood operation in eastern Montana and required the construction of a pipeline from southwestern Wyoming into northeastern Montana and northwestern North Dakota to service a number of projects. He stated the project would have involved an investment of about $275 million in eastern Montana. **Mr. Anderson** stated that when that program was presented to the Legislature the price of oil was around $30/barrel but immediately dropped after the termination of the Arab Oil Embargo. He said in 1983, the Legislature had been clearly informed that the economics were dependent upon an oil price of about $27/barrel. He said by 1986 the price of oil in Montana was down to about $12/barrel, a price which has remained constant with only a short "blip" in 1990 during the Gulf War. He stated oil has not been at a high enough price for a long enough period to justify an expenditure of $275 million. He noted, however, that if the price of oil would go back up and a pipeline could be built, Shell would go ahead with the plan, since the company had run a successful pilot project.

After establishing that the price of oil had already dropped approximately $3/barrel since the provisions in SB 18 had first been presented to a legislative Committee, **Senator Towe** asked if **Mr. Anderson** thought that the oil companies proposed investment would still occur. **Mr. Anderson** stated if oil prices "sink clear down to the bottom", nothing would happen. He asked that **R.E. Sheffield** have the opportunity to address the question.

Mr. Sheffield reminded the Committee that the historical price of crude, with some "blips up and down", had consistently ranged between $15 and $20/barrel in today's dollars. He stated Shell believed the price will stay in that range over the long-run, and added that for the projects that are being proposed in conjunction with SB 18, a long-term view is required. He noted Shell's interpretation was that current oil prices were an aberration which would drive some production out of the market and cause demand to, once again, catch up with supply.

Senator Towe asked whether Shell would make its projected investments if the price did remain at current levels. **Mr. Sheffield** stated Shell would make that investment.

Senator Towe asked if that would be the case even at $12/barrel. **Mr. Sheffield** responded that Montana mix crude was penalized

because of asphaltene content, so the crude produced at Cedar Creek Anticline was being sold for $12.50/barrel in October. He emphasized that the projected projects in Montana are currently on the "bubble", and the tax incentive can make up the difference in slight fluctuations in crude prices. He noted that rate was another variable. He said the chart of possible Shell projects he had referred to in his testimony were not only in Montana; the clear money makers are in the Gulf of Mexico or west Texas, not in Montana. He stated the companies could not provide any iron-clad guarantees because there was no guarantee that the wells which would cost $1 million apiece would tap into significant reserves or economic production rates.

Senator Towe said he had asked **Mr. Sheffield** whether Shell was prepared to "put the company's money where its mouth was" during the Revenue Oversight Committee meeting when the proposal was first present. He passed out a transcription of those comments to the Committee (Exhibit #10) and inquired whether **Mr. Sheffield** had anything further to add. **Mr. Sheffield** responded that **Senator Towe** had proposed that the companies be required to refund the tax incentives they received if they did follow through on their stated goals. He informed the committee that Shell and Meridian would only not "follow through with the projects as described", because they were losing money. He stated it did not make sense that the companies would have to pay more taxes because they lost money and had to terminate the development. He appealed to **Senator Towe's** "basic sense of fairness".

Senator Towe said **Senator Halligan** had made the valid point that tax incentives are most effective if they are pinpointed. He added a good example of that was "the window of opportunity" accorded to coal. He stated the same principal could be applied to the situation under discussion; SB 18 could be amended to stipulate a certain number of new wells or a certain amount of investment was necessary or the incentive would not be present. He asked if that would be more effective as a state policy. **Mr. Sheffield** replied the Legislature would need to resolve that issue. He stated that oil was a risky proposition and, although there were no guarantees, the economics of these projects really depended upon the having the incentives in SB 18.

Jerome Anderson commented that the oil and gas industry could not be fairly compared to the coal industry; the circumstances, the possible uses, and the market situation of the two industries are totally different. He added that the issue which prompted the "window of opportunity" legislation was vastly different.

Senator Towe distributed the letter from the North Dakota Office of State Tax Commissioner (Exhibit #11) and said the letter indicated that most of the oil produced by horizontally drilled wells in North Dakota had been taken out of the wells within the first 15 months. He cited the 18 month holiday SB 18 would grant for new horizontal wells and asked industry representatives if

that provision had been placed in SB 18 in order to circumvent taxation on the majority of the oil production from such wells. **Stan Kaleczyc** responded that was not the intent of SB 18, and noted that, although he had not seen the letter, it seemed to indicate that a number of the wells were low producers. He stated that data would indicate that those wells had never produced at the level the company anticipated. He stated that those bad economics actually demonstrated the inherent risk of the oil industry. Addressing the more general proposition that such wells tended to deplete quickly, **Mr. Kaleczyc** stated that was not the case; a company would spend over $1 million to drill a horizontal well and could not expect to recover that investment within the first 18 months or 3 years of production on that well.

Brent Smolik contributed more specific information about the payout and the return. He agreed that some wells have a steep decline in production and said a specific geological formation characteristically displays that tendency when it was "somewhat naturally fractured". He added, however, the economics of a well cannot be based upon the economics specific to the first 18 months of production. He stated the project Meridian had identified in eastern Montana would "very clearly" have about a 20 year life, hopefully longer. He stated if Meridian really thought that the well production would be depleted in the first 18 months, it would not be able to afford the projects.

Mr. Sheffield referred committee members to a cumulative production chart for Meridian's wells (Exhibit #12). He noted that the chart tracked months on production and barrels of oil produced and showed that of the ultimate recovery of at least 150,000 barrels of oil, the chart showed that in 18 months only about 70,000 of those had been recovered. He stated there was no economic possibility that Shell would drill wells that produce for 18 months and then "cut and run" to get out of paying taxes to the state. He explained the extension from 12 to 18 months merely makes drilling those wells more attractive because the company gets to recover its capital investment more quickly.

Senator Eck asked if there were wells that did have very large production levels which tapered off dramatically after the first 15 months. **Mr. Sheffield** responded that Austin Chalk wells drilled around San Antonio, Texas were notorious for paying out while they were being drilled, he added that area has a naturally fractured reservoir. He stated the rock formations in eastern Montana are not naturally fractured, and the oil companies are dealing with a variation in porosity which means that the decline function is much flatter for a very long time. **Mr. Smolik** added that Meridian has never been able to put a project into full scale development in areas where wells do exhibit that kind of a decline because "they never came anywhere near to paying out". He alluded to a 230,000 acre position in the Austin Chalk that Meridian had never been able to develop. He concluded that some wells play out in months, but they were not pertinent to the discussion because the company would not be developing such areas

into a project.

Senator Towe said he had a 20 page list from the North Dakota Office of State Tax Commissioner of renditions of oil well producers in the state of North Dakota. He picked #72, a Meridian oil well, and noted that 11 months after it went into production it was only producing about one-fourth the amount of oil it had at first. **Mr. Smolik** asked if **Senator Towe** had the cumulative production from that well over that period, because he suspected that well was in an area which Meridian had not further developed. **Senator Towe** responded 17,311. **Mr. Smolik** said such wells in North Dakota typically cost about $1-$1.3 million to drill, and added that he could almost assure the Committee that Meridian did not develop the area beyond the first couple of wells given that cumulative production level. He reiterated that Meridian was not hoping to develop projects in Montana which have a rapid decline rate after an 18 month period. Instead, he said, the projects Meridian considered worth pursuing are long-life, low permeability reservoirs that have been identified.

Senator Towe submitted that page of the list for the record (Exhibit #13). He stated that glancing through the list, it becomes obvious that the bulk of production from many wells was gone after the first 12 months. He stated he had strong reservations that Montana should be extending its tax holiday on horizontal wells to 18 months, because, in effect, that extra six month holiday becomes quite a substantial holiday on oil production. **Mr. Sheffield** referred again to the cumulative production curve, which shows that those wells only produce a fraction of their total production in the first 18 months (Exhibit #12). **Jerome Anderson** pointed out that a well which yielded only 17,000 barrels would not come close to recovering its cost. He said even if the price of that oil goes up to $40/barrel, the company would only recover about $340,000. He stated when that sum is compared to $1.5 million in cost, it becomes clear that it makes no sense to go into that kind of a project and spend three the amount of money that will be recovered.

Senator Doherty asked **Mr. Anderson** what the composite effective tax rates on crude oil for Montana, Wyoming and North Dakota were. **Mr. Anderson** replied that Montana's composite effective tax rate was 12.7 percent, Wyoming's 12.5 percent, and North Dakota's 11.5 percent.

Senator Doherty asked **Stan Kaleczyc** if Montana's tax rate were dropped to 11.5 percent for Meridian and everything else were equal, would Montana be as competitive as the other states, aside from Colorado, with which Meridian does business. **Stan Kaleczyk** said he understood that the incentive package in SB 18 would put Montana's effective rate approximately equal to North Dakota's rate. He noted that more important, however, was the question whether SB 18 would make the Montana projects competitive within Meridian, i.e. economically viable compared to Meridian's other

options. He stated the incentives in SB 18 would make those projects competitive within Meridian so that Meridian's management could justify putting the investment dollars in Montana.

Senator Doherty asked **Senator Halligan** why SB 18 would grant the Board of Oil and Gas Conservation (BOGC) rule-making authority and remove it from the Department of Revenue (DOR). **Senator Halligan** responded he did not know.

Senator Doherty asked that someone explain the reason for the shifting authority. He also asked that a DOR representative explain how many people were currently doing this work and a BOGC representative explain how many new people it would be necessary to hire in order to assume the additional authority. **Tom Richmond, BOGC,** stated the BOGC could not afford to hire anyone. **Van Charlton, DOR,** stated DOR did not envision hiring any new employees if SB 18 were approved.

Senator Doherty noted that DOR was going to lose some responsibilities, but that the BOGC would be gaining some. He asked how many new employees the BOGC would need to shoulder the additional responsibilities they would gain if SB 18 were adopted. **Mr. Richmond** said SB 18 contained two primary parts, regulating horizontal drilling and determining the increment of new oil produced to the existing declining rate. He stated the horizontal drilling would have no effect on BOGC because it already deals with horizontal drilling on a periodic basis and has the necessary rules in place. He stated determining what oil production should be taxed at the lower incentive rate would involve both the staff and the board. He stated SB 18 would establish the increments as a part of a public hearing which would require "some up-front staff work" before the public hearing and before the presentation to the board after the public hearings. **Mr. Richmond** agreed that SB 18 would require a substantial amount of staff work depending upon how many projects were proposed. He noted if BOGC only had to evaluate Shell's and Meridian's projects, it might disrupt the staff's workload for a period of time but could probably be dealt with in a fairly normal manner. He stated, however, if BOGC is faced with several projects every hearing, it would represent a larger problem.

Senator Doherty asked that a representative of the Governor's office explain the public policy reasons for taking a tax determination away from DOR and assigning it to the BOGC which has not been known as a regulatory body that may not be captured by the industry that it regulates. **Mr. Hill** responded he could not answer that question, but would be happy to provide the information at a later time.

Senator Doherty noted one of the criteria for targeted incentives intoned by **Senator Halligan** was the creation of good paying jobs that also provide health benefits. He asked that both the independents and the major oil companies identify what kind of

health benefits they provide for their employees. **Mr. Sheffield** replied that Shell provided its employees with several health insurance options, and added that all Shell employees are covered by "a comprehensive, very competitive health insurance program". He noted the roustabouts that work Shell wells are employed by the independent companies. **Robert Marquiss** stated that Updikes furnished its employees with a hospital insurance policy, which did not include their spouses. He noted his company's employees are also covered by a life insurance policy after they had been with Updikes for six months. **Brent Smolik** stated that Meridian Oil had a quite comprehensive medical plan with a number of different options. He said there was almost no monthly cost to the employee. He added that all employees: hourly/salary; exempt/non-exempt; field workers/office workers were covered by the same policy.

Senator Doherty asked how many of the people filling the projected 350 new jobs created by SB 18 would be covered by health insurance. **Mr. Smolik** said he was not qualified to answer that question. He noted, however, that many of those new jobs would be in support industries like trucking, restaurants, and hotels.

Senator Gage corrected a statement made by **Senator Towe** who had indicated that 60 percent of the oil had been produced in those properties in the first 12 month period. **Senator Gage** noted that what the letter actually stated was significantly different -- that 60 percent of the wells were low producers, either initially or by the time that the 15 month period expired. He asked **Robert Marquiss** if different kinds of service equipment was needed for horizontal wells. **Mr. Marquiss** replied yes.

Senator Gage asked if that equipment would be run by the regular rig crew. **Mr. Marquiss** responded that instead of running a three man crew it would require a four-man crew.

Senator Gage asked how the incentives contained in SB 18 would apply in a case where an oil company decides to drill twice as many wells in an area as it had previously planned. **Mr. Sheffield** replied that the key point was that it can be definitely ascertained what a field will do if no more new wells or new well developments are drilled. He explained that established wells have a seven to eight percent annual decline rate and well-known methods exist whereby the future production of those wells can be predicted based upon their current production rates. As a result, **Mr. Sheffield** noted a person can look at the total production from a field, and project that decline rate. He stated any difference between the projected decline rate and actual production can be attributed to enhanced recovery projects, and only that incremental extra production would be taxed at the lower rate.

Senator Gage noted that the company would have to justify to the satisfaction of BOGC that the oil production it was attributing

to enhanced recovery projects was actually correct. **Mr. Sheffield** agreed, but reiterated that there were very excepted formulas whereby those rates could be accurately calculated.

Senator Gage asked if the BOGC agreed. **Mr. Richmond** responded that was how he understood SB 18; the change in the waterflood pattern or an infield drilling program or some other expansion would result in an increment and that increment would get the tax break. He noted, however, that some projects like a thermal project could go directly into a tertiary recovery process without any primary production. According to **Mr. Richmond**, then all the production would qualify for the lower rates. He said that exists as a possibility in Montana.

Senator Gage noted that was current law. **Mr. Richmond** replied it was current law as it applied to tertiary production.

Senator Gage commented that the reason the rule-making would go to BOGC was because that was where the expertise on production projections would be located. He stated DOR probably did not have that expertise and cautioned that lack would pose a problem because it could easily create a tendency to rely very heavily on information from the oil companies.

Senator Harp asked **R.E. Sheffield** to put up his "hurdle rate" chart (Exhibit #12). He asked what rate of return Shell would consider "profitable" on an investment of $1.5 million. **Mr. Sheffield** said the goal for return on investments stated in the annual report was 12 percent. He added, however, that percentage needed to account for the risk of all drills, including those that were not profitable.

Senator Yellowtail asked **Senator Halligan** why it was necessary to deal with SB 18 during this special session of the Legislature. **Senator Halligan** responded the oil companies were in the process of planning their investment decisions for the next five years; a year from now when the regular session could take up this issue, the general plan will have been developed and those investment funds will have been allocated for the next five years. He stated the opportunity is now and the price of oil is relatively stabile. He emphasized that SB 18 was not an attempt to take existing revenues and actually offered Montana a chance to develop a certain stability in oil production and its concomitant revenues. **Senator Halligan** stated SB 18 represented a proactive approach to the current financial problems in the State; by providing incentives for new recovery techniques, SB 18 could add extended life to existing oil fields and some stability in oil production and revenues that would ameliorate Montana's financial situation and reduce the need to cut the State's budget.

Senator Yellowtail stated that he was "tantalized" by the prospect alluded to earlier that SB 18 would create 350 new jobs. **Senator Yellowtail** noted that if the Legislature were truly going to evaluate the effectiveness of the incentives in SB 18 as

suggested by **Senator Halligan** and the sunset provision in SB 18, empirical benchmarks by which to judge whether the incentives are working and worth continuing would be necessary. He asked that **Stan Kaleczyc** "nail down" his earlier generalizations by defining the method of analysis used to arrive at those numbers and by enumerating the sectors, locations etc. of those prospective jobs. **Stan Kalezyck** responded that Meridian had conducted a survey of people who provide direct services to drill rigs after the Revenue Oversight Committee members had requested the same information. He said that survey determined that for each operating drill rig, the equivalent of 44 full time employees (FTEs) worked either directly on the rig or provided direct services to that rig with a payroll of approximately $140,000 per month. He said Meridian's projected drilling program of about 110 wells drilled over five years would employ approximately two drilling rigs, and 88 FTEs, working full time for five years. **Mr. Kaleczyc** stated according to estimates from the University of Montana Business School and other estimates from the industry, every direct job associated with a drilling rig will create an additional three to four jobs in the community. He noted those jobs are usually connected to parts of the service industry. He stated the presentation he had made used the multiplier of four on the 88 direct jobs which would amount to approximately 350 secondary jobs at the local level. **Mr. Kaleczyc** noted that it would be difficult to measure and define those additional secondary jobs and suggested that the well count would be the best measurement of the incentive's effectiveness. He added that the actual capital investment could serve as a helpful secondary benchmark.

Senator Yellowtail said that part of the allure of any legislation like SB 18 was the very public argument that it would produce 350 jobs. He stated that, in the interest of accountability, the Legislature needed to be able to identify the success or failure of the incentives by some empirical means at some point in the future when it reevaluated this measure. He asked **Stan Kaleczyc** if he agreed. **Mr. Kaleczyc** stated he did not object to any empirical figures that could be developed in the future whether by the Legislature or a Committee of the Legislature or the private sector. He said he was not an economist and did not know how the Legislature would measure the secondary employment attributable to the drilling activity.

Senator Yellowtail asked if **Stan Kalezyck** would agree that the Committee should dismiss that projection if he could not offer some means by which the Committee might empirically evaluate that outcome at some point years hence. **Mr. Kalezyck** responded he had not said that it could not be measured, just that he did not know how. He stated that obviously someone from the University of Montana has a method of measurement and therefore that projection should not be taken lightly.

Senator Yellowtail invited the lobbyists to approach the Committee with the methodology to specify this projection and

with a proposed methodology by which the Committee might evaluate the legitimacy or the effectiveness of that projecting. He asked that his invitation be placed on the record.

Senator Towe referred to the projections that the companies had provided the Committee which reflected the combined Meridian and Shell oil projects (Exhibit #5, page 6). He calculated 80 percent of those projections for the Committee's information (Exhibit #14). He noted that implicit in all testimony and very specific in some was the idea that SB 18 was a means of generating new revenue and in no way affect existing revenue. He noted that SB 18 was written in such a way that if horizontal drilling is certified by BOGC as such, there would be an 18 month holiday instead of the 12 month holiday specified in current law. He asked if the companies would be applying for this holiday only regarding brand new wells or if extensions of existing wells would also apply. **Stan Kalezyck** verified that **Senator Towe** was referring to a situation in which an existing vertical well bore would be converted to a horizontal well. He stated in such cases the oil industry's intent was that the 18 month holiday would only be on the production increment which can be attributed to the new drilling. He explained that if a well which was producing 40 barrels as a vertical well, was made over into a horizontal well and produced 100 barrels, then the holiday would apply only to the increment of 60 barrels.

Senator Towe noted that the language in SB 18 did not reflect that intent. **Stan Kalezyck** stated that an amendment should then be drafted and adopted to clarify that intent. **Mr. Anderson** agreed that the specific intent of SB 18 was not to affect existing revenue.

Senator Towe asked if the oil companies would use the incentives contained in SB 18 to implement enhanced recovery measures on wells which are presently decent primary or secondary producers in order to reduce their taxes on that production. He noted the incremental decrease would be a substantial amount for the rest of that well. **Mr. Sheffield** responded that current tax rates would apply to the existing production which would continue to decline. He stated the only portion taxed at a lower rate would be any incremental production resulting from enhanced recovery that exceeded the normal decline.

Senator Towe asked if the BOGC would determine what the old production would have been. **Mr. Sheffield** replied that the companies would work with the BOGC. He reiterated that well-known and well-accepted methods existed for predicting continuing production and the normal rate of decline.

Senator Towe asked if it was the oil companies' intent in SB 18 that horizontal drilling would be classified as either secondary or tertiary methods. **Mr. Sheffield** responded most of the horizontal wells that Shell would drill would be in the company's well-developed waterflood. He added, however, any horizontal

wells drilled in areas that are not currently developed would be primary wells.

Senator Towe asked if the oil companies intended to have any horizontal wells classified as secondary or tertiary wells. **Jerome Anderson** replied it was not the specific intent because horizontal wells could be primary, secondary or tertiary. **Stan Kalezyck** added that the horizontal wells Meridian would be drilling would be for both primary and secondary production.

Senator Towe noted he was trying to address the lack of clarity in SB 18. He stated that on pages seven and eight the definition of tertiary included the phrase "any other method approved of by BOGC as a tertiary recovery method". Both **Stan Kalezyck** and **Jerome Anderson** informed **Senator Towe** that the language he had cited was in existing law, and SB 18 would simply place it in a different section of the codes.

Senator Towe asked if the language referring to secondary production on page 19 was also in existing law. **Mr. Anderson** replied "no". **Senator Towe** asked if the oil companies intended that BOGC would have the authority to classify anything they wanted as a secondary recovery method. He asked what was to prevent oil companies from having primary recovery classified as secondary recovery by virtue of its being a horizontal well. **Tom Richmond** admitted the language "whatever the BOGC might find to be a secondary recovery method" might be a little loose. He added, however, that horizontal drilling is a completion technique whereas the terms secondary and tertiary referred to recovery techniques. He also said that anything BOGC would approve as secondary or tertiary recovery would be done on a project by project basis, not a well by well basis.

Senator Towe asked **Mr. Richmond** to clarify his use of the term "completion". **Mr. Richmond** replied "completion" indicated the way in which a well was actually constructed, not the way it is recovering the product.

Senator Towe asked **Mr. Richmond** if, in order to ensure that there would be absolutely no decrease in existing tax, the BOGC would have to evaluate the normal expected production of every single well with secondary or tertiary recovery methods in order to determine the existing and the incremental production for tax purposes. **Mr. Richmond** replied yes.

Senator Towe asked if that would not be a substantial burden. **Mr. Richmond** replied he was less concerned about Shell and Meridian projects because BOGC has kept decline curves on their projects, and has existing data which makes the decline easy to project. He stated the projects which have small numbers of wells on which BOGC has less established data concern him the most.

Senator Towe noted that given the great and recent fluctuation in oil prices over the last couple of weeks, the total tax obviously

was not very significant in the overall scheme of investment decisions. **Mr. Sheffield** reiterated that Shell believes that historically the price of oil has remained within the band of $15-$20/barrel. He also noted that when the price of oil changes, it changes everywhere, but the tax structure does not unless the Legislature acts upon it. He stated that when oil companies look at their competitive opportunities "it is the tax structure which could encourage [them] to go one place or another".

Senator Towe asked if Shell had also gone to North Dakota to ask for a reduction in taxes. **Mr. Sheffield** replied no.

Senator Doherty asked how the production of a well was measured as it comes out of the ground. **Brent Smolik** replied that there were a number of different ways to physically gauge the amount of oil, but there was no gauge like those on a gas tank. He noted the simplest way would be to lower a tape from the top of the tank and measure the level each day. He said there are turbine-type meters which can be floated through a pipeline which record the number of barrels passing by that meter.

Senator Doherty asked if the production of each well were gauged and recorded on a daily basis. **Mr. Smolik** replied it would depend upon the volume of the well; if the well produced a small volume it would not be necessary to gauge it every day. **Mr. Sheffield** added that there are very carefully calibrated measuring devises that are proven monthly and used at transfer points to provide a double check on the well counts. He noted that all the production that goes through that transfer point are allocated to the wells based on well tests, and those gauges are very important because both the buyer and seller of oil have a very keen interest the accuracy of the measurements. He stated a very tight control is kept on production.

Senator Doherty asked if the fine-tuning takes place at the collection place rather than at each individual well. **Mr. Sheffield** replied that each individual well was also measured by well tests. He noted the measurements at the transfer point function much like balancing a checkbook; the sum of the well tests are checked against the total amount at the transfer point. He noted any necessary corrections are allocated back to the individual wells.

Senator Doherty asked that a "well test" be defined. **Mr. Sheffield** replied a well test was when the oil from a well went through a special separator instead of into a mass aggregate tank. He explained those separators have gauges which measure the volume of oil for a specified amount of time like 12 hours. He said that measurement would be extrapolated into a daily and monthly rate which would then be allocated back to that specific well from the total production of the field.

Senator Doherty asked how often well-tests were carried out. **Mr.**

Sheffield replied the frequency depended upon the volume of production; in some cases well tests are done once a month, some cases two or three times a month.

Senator Doherty remarked that there would be an extreme need for accuracy if the Legislature were to grant different tax rates for incremental production, or if one well would be taxed at a lower rate and another at a higher. **Mr. Sheffield** understood **Senator Doherty's** point, but noted he was making it more complicated then necessary. He explained BOGC would only need to look at a field's total production since the production of the entire unit had been determined. He said anything above the established very easily projectable decline rate would be the incremental production attributable to either horizontal wells or enhanced recovery projects. He stated the oil companies would have a keen interest in having accurate numbers, and he was certain that there would be a lot of cross-checks.

Senator Van Valkenburg asked **Mr. Richmond** to describe the BOGC. **Mr. Richmond** said that the Board has seven members who are appointed by the Governor for staggered four year terms, four of which expire in general election years and three in the off year. He said of the seven members, three are required by statute to be oil industry members with experience in oil and gas production, two are at-large public members, one must be a land owner with minerals and one must be a landowner without minerals. He stated that one of those seven members must be an attorney.

Senator Van Valkenburg asked **Mr. Richmond** to outline how the BOGC viewed its role with respect to the protection of the public interest. He asked that **Mr. Richmond** concentrate particularly on how that would apply to the implementation of SB 18. **Mr. Richmond** replied that the BOGC is charged with three basic functions: the conservation of resources, the prevention of waste, and the protection of relevant rights. He explained BOGC must ensure that each person owning interest in oil and gas gets their fair share of the returns from oil and gas productions. He noted that BOGC also has other administrative duties and obligations. **Mr. Richmond** said that the public's interest also was part of BOGC's "relevant rights" function; he stated the public has an interest and that BOGC sees itself as having an obligation to protect the public's interest. Addressing the implementation of SB 18, **Mr. Richmond** stated "fairly substantial" rule-making would be required, and BOGC would be asked to do some things it has not done before, like determining the increment. He added, however, those new responsibilities were "not entirely alien" to BOGC or its staff. He explained BOGC has for many years plotted the production of each secondary recovery unit and calculated the reserves in each of the major fields in Montana. He stated BOGC collects data in connection with DOR on volume, values, and public status for people who might want to use any of that information.

Senator Van Valkenburg commented that most of the questions and

concerns about SB 18 centered around the issue of the credibility of the industry in terms of its living within the stated objectives and the promises of future economic benefits to the state of Montana. He asked if BOGC sees that it has a role with respect to representing and carrying out the public interest and making sure that the industry abides by not only the letter but also the spirit of those objectives and proposals as well as functioning as a liaison between the industry and the Legislature. **Tom Richmond** said BOGC would see itself as playing an important role in the process and providing technical expertise which was not available in other parts of state government. He noted that technical expertise would be used to determine that the methods used and presented to BOGC are reasonable, follow ordinary uses of engineering and geology, and are supported by the data available. He stated that all of BOGC's meetings were open to the public, and all testimony would be given under oath by qualified experts and presented to the board as such. He said that BOGC staff and geologists would have some direct input in the BOGC decisions based on their technical merit. He reiterated, BOGC "sees itself as a public body whose purpose is to best serve the public".

Senator Van Valkenburg noted BOGC interpreted its role as not just serving the industry. **Tom Richmond** replied "he would hope not".

Senator Doherty asked **Mr. Richmond** how he would react if SB 18 were amended to leave the primary responsibility for tax regulation with DOR and give BOGC the important technical consultation role. He asked also if **Mr. Richmond** were aware of any other instance where BOGC or any other commission in Montana Government impart tax rates on the industry it is charged with regulating. **Mr. Richmond** replied BOGC determines the tax rates for its conservation taxes, which, he added, are set at the maximum. He said BOGC would be willing to cooperate no matter how the Committee decided to set the responsibilities. He stated, however, there needed to be technical expertise on oil and gas and certainly on reservoiring and geology represented. He said DOR did not assert that they possess that kind of expertise, nor, he assumed, did they want to develop it. **Mr. Richmond** noted he did not want to have to develop any additional expertise on tax. He informed the Committee that one advantage of having BOGC do much of the work, was that it has an established public hearing process in which everyone participates: not just the bureaucrats, not just the industry. He noted he assumed that SB 18 would provide that BOGC adopt rules in consultation with DOR, and said he would "take that at face value". He said DOR should have a representative who attends the hearings on these projects and participates.

Senator Eck noted that **Mr. Richmond** had said that BOGC did not have enough money to carry out the additional requirements they would receive under SB 18. She asked if he would recommend that the Committee find some method whereby the industry could pay the

costs. **Mr. Richmond** replied the industry would probably say they already pay the costs, and that was true. They do pay the bills.

Senator Eck said the Committee had talked previously about not allowing permits if a department did not have adequate staff to carry out the necessary responsibilities. She stated the available alternatives would be either not issuing the permits or making sure that somehow state agencies and commissioners have the expertise and staff necessary to do a credible job. **Mr. Richmond** noted that in such situations a state entity would need to realigning its responsibilities to assume the new workload with whatever staff it had. He said that perhaps the best thing that could happen is that BOGC is "simply overloaded with all of these fine projects" since the State then could probably afford more staff. He stated, however, he was not sure that BOGC would be overloaded and that staff could certainly do some of the projects without any real disruption in the ability to do BOGC's other work.

Senator Eck said the thing that concerned her most about SB 18 was that the Legislature was in a special session with a tight schedule. She stated that economic development is truly important to consider, but noted that the Legislature has already been confronted with proposals that would decimate the University System which was considered to be probably the highest priority to Montana's future economic developmental by "most everyone" who has evaluated the situation. She mentioned that the Legislature was not addressing the concerns people had raised about the demise of small business, but had consented to review a complicated new proposal from an "an industry with tremendous clout that has been able to get the Governor's ear". She conceded waiting until the next session might not be a good idea, but asked why the proposal in SB 18 was not submitted to the Legislature nine months ago. **Stan Kalezyck** responded that Meridian's Montana projects had not "come to the top of the barrel" for consideration a year ago, largely because the company did not have as many dollars available for capital investment as was being projected for 1994. He added that Meridian was not internally ready to address and develop a five year program for its Montana fields a year ago. **Mr. Kaleczyc** explained that he had received a call from the company in July which had advised him that the engineering department had been considering Montana projects, but that they were not economic. He stated the special session presented a "serendipitous" chance for the Legislature to revue and adopt tax incentives which would make those projects economic and adopt the only proposal in the session which created at least the possibility of generating a modest amount of new revenue in the near-term.

Senator Towe said that in the Revenue Oversight Committee **Bill Tulloch, Meridian Oil** was asked whether any other states had a special provision for horizontal drilling to which he responded "no". He asked if anyone else would like to comment. **Mr.**

Tulloch commented he still did not know of any state which had a specific provision for horizontal drilling in their statute. He added, however, a number of states had various types of incentive packages which included horizontal drilling.

Senator Towe said he did not want to create a situation in which the oil companies would use the provision on horizontal drilling in Montana statute as a means to pressure other states into granting similar provisions. He asked if the Committee should not instead look for another means to provide a comparable incentive. **Mr. Tulloch** asked for clarification. **Senator Towe** replied he was not sure there was a good answer to his question. He noted, however, if the Committee were serious about granting an incentive, it might be more appropriate to design a statutory provision similar to what other states have done instead of placing a specific provision for horizontal drilling into Montana's statute.

After being recognized, **Perry Pearce, Director of State Government Affairs, Meridian Oil,** stated Louisiana and Oklahoma both have incentive provisions specific to horizontal wells. He explained that Louisiana has a lower severance tax rate on horizontal wells which is in place until the horizontal well recovers 2.5 times of the total investment in drilling the well and Oklahoma grants an exemption for any well drilled prior to July 1, 1994 that stays in place until the horizontal well reaches payback or 24 months, whichever occurs first. He stated both of the provisions are much more complicated that simply granting an 18 month holiday because they would require a regulatory agency to determine the amount of investment in the well and how much is returned in production sales. He noted also that the tax reduction period would vary along with recovery rates from wells. **Mr. Tulloch** said he had a copy of a report summary which was going to be presented to the Energy Council later in December and he offered to try any get copies of the Louisiana and Oklahoma statutes.

Mr. Sheffield added that Montana and California are the only two states in which Shell has a "ready to go project" involving the drilling of horizontal wells. He said he did not believe that California had any particular incentive. He stated, however, that Shell's involvement with SB 18 could be attributed to the fact that the extra incentives are necessary to be sure that Shell's proposed project in Montana would be economic, more attractive, and able to "beat out" the other competing alternatives for Shell's capital investments

Closing by Sponsor:

In closing **Senator Halligan** addressed the appropriateness of SB 18 to the special session. He noted that **Representative Ewer** brought up the probable severe cuts in human services and education and stated that while he rarely voted for those kinds of cuts and might not vote for them this session, it was

necessary for the Committee and the Legislature to "be proactive and look at the future". He stated SB 18 offered Montana the possibility of new production and revenue while protecting its current revenue base. He reminded the Committee that SB 18 was constructed to reflect each of the criteria the NCSL had identified as necessary for responsible and effective tax incentives and stated there were specific ways in which the industry's "track record" could be empirically tracked and submitted for legislative review. He mentioned that perhaps the Revenue Oversight Committee could receive regular reports from BOGC containing the drill count, attributable employment, the amount of capital investment, etc.

Senator Halligan expressed his wish that banks truly had reciprocal "iron-clad" contracts. He noted, however, that bank contracts usually stipulate something along the lines "if you have 100 percent collateral, they will loan you the money". He reminded the Committee that the banks would not loan the ethanol industry any money unless the Legislature approved the industry's incentive. He stated the people testifying on behalf of SB 18 were not going to make promises they could not keep and nothing was absolute in the oil business. He reiterated, however, that SB 18 would allow the Legislature to establish benchmarks and thereby empirically follow the industry's activity in order to determine whether the incentives work in the available window of opportunity.

Senator Halligan stated that SB 18 provided an opportunity to attain some economic stability for the people in eastern Montana as well as prevent further environmental damage by continuing activity in existing fields. He noted by extending the life of those fields, SB 18 would create not only the primary but also the derivative jobs to which the people from eastern and northeastern Montana had attested. He said SB 18 would not affect the budget cuts the Legislature currently faced, but would put a proactive policy in place that might make it unnecessary to make those difficult decisions in the future. He concluded by saying that he would welcome a discussion of amendments which could provide the empirical basis by which to evaluate the incentives or establish BOGC's appropriate role in the process.

After resuming the chair, **Chair Halligan** announced that the Committee would hold hearings on a two bills and take action on SB 18 the following day while industry representatives were still in town. He urged those committee members who were considering amendments to have those amendments drafted for the next meeting.

ROLL CALL

SENATE COMMITTEE TAXATION DATE 2 December 1993

NAME	PRESENT	ABSENT	EXCUSED
Sen. Halligan, Chair	X		
Sen. Eck, Vice Chair	X		
Sen. Brown	X		
Sen. Doherty	X		
Sen. Gage	X		
Sen. Grosfield	X		
Sen. Harp	X		
Sen. Stang	X		
Sen. Towe	X		
Sen. Van Valkenburg	X		
Sen. Yellowtail	X		

FC8

Attach to each day's minutes

STATE OF MONTANA - FISCAL NOTE
Form BD-15
In compliance with a written request, there is hereby submitted a Fiscal Note for SB0018, as introduced.

ESCRIPTION OF PROPOSED LEGISLATION:

n act providing reduced net proceeds tax rates and reduced severance tax rates on the incremental production of oil from nhanced recovery projects that begin after December 31, 1993, and before January 1, 2003; exempting from net proceeds axation for a period of 18 months the production of oil from horizontally completed wells; requiring that the Board of Oil nd Gas Conservation approve enhanced recovery projects in order for the projects to qualify for the reduced tax rates; and roviding for an immediate effective date and an applicability date.

SSUMPTIONS:

.. The data necessary to determine the impact of the proposed legislation is not available (MDOR).

SENATE TAXATION
EXHIBIT NO. 4
DATE December 2, 1993
SB 18

ISCAL IMPACT:

xpenditures:

he proposed legislation will not have a significant impact on Department expenditures.

evenues:

let proceeds and severance tax revenues from *existing production* will not be impacted by the proposed legislation.

FFECT ON LOCAL REVENUES:

he local government impact from net proceeds tax revenues cannot be determined given the available information.

ONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

mpacts to future revenues will depend upon the amount of new production resulting from the proposed tax incentives.

ECHNICAL NOTE:

he title of the bill states that oil production from horizontal wells is exempt from the net proceeds tax for the first 18 months of production. The proposed legislation exempts both oil *and* natural gas production from the net proceeds tax for he first 18 months of production from horizontally drilled wells.

NOT FOR DISTRIBUTION

Dave Lewis 12-1
DAVE LEWIS, BUDGET DIRECTOR DATE
Office of Budget and Program Planning

MIKE HALLIGAN, PRIMARY SPONSOR DATE
Fiscal Note for SB0018, as introduced

SENATE TAXATION
EXHIBIT NO. 5
DATE December 2, 1993
BILL NO. SB 18

Proposed Incentives

To Attract Capital Investment

In Montana

For

New Drilling And

Enhanced Oil Production

MONTANA TOTAL CRUDE OIL PRODUCTION

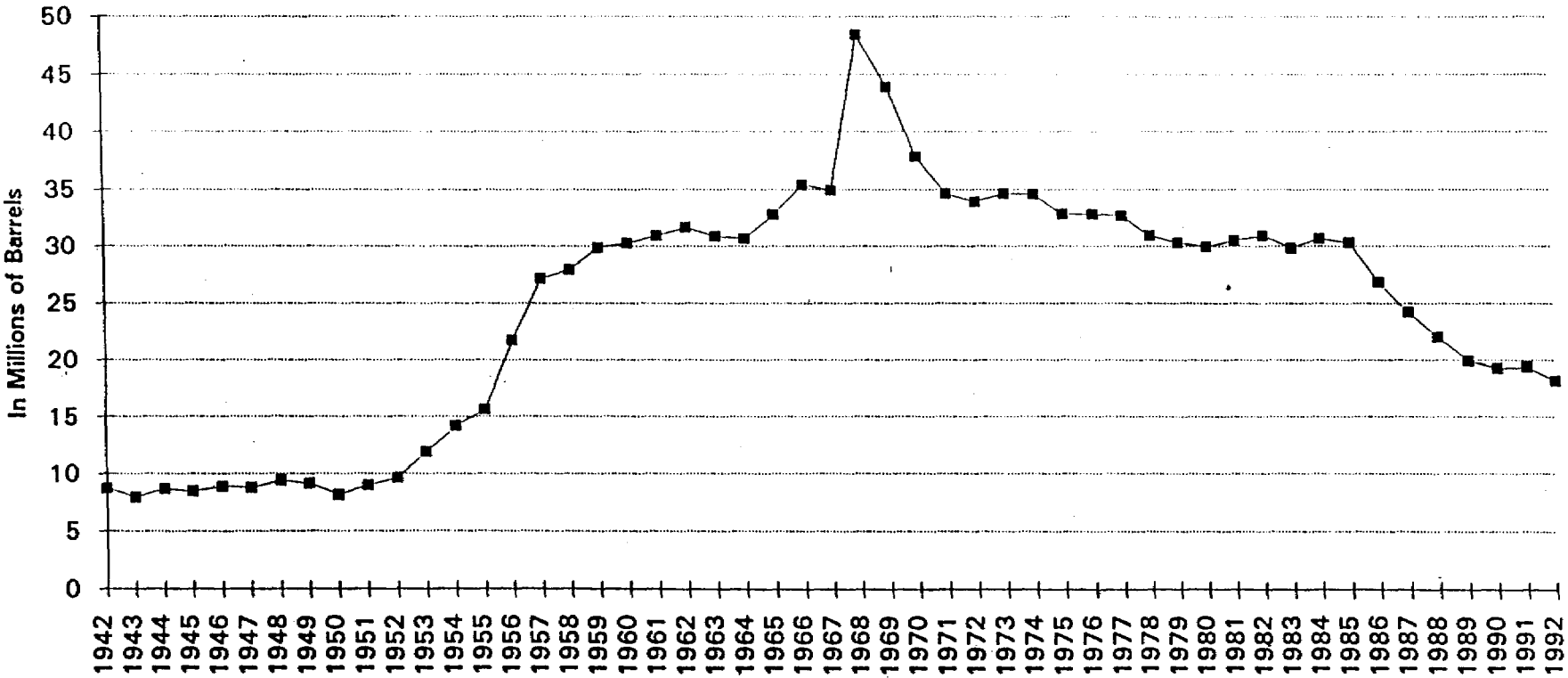
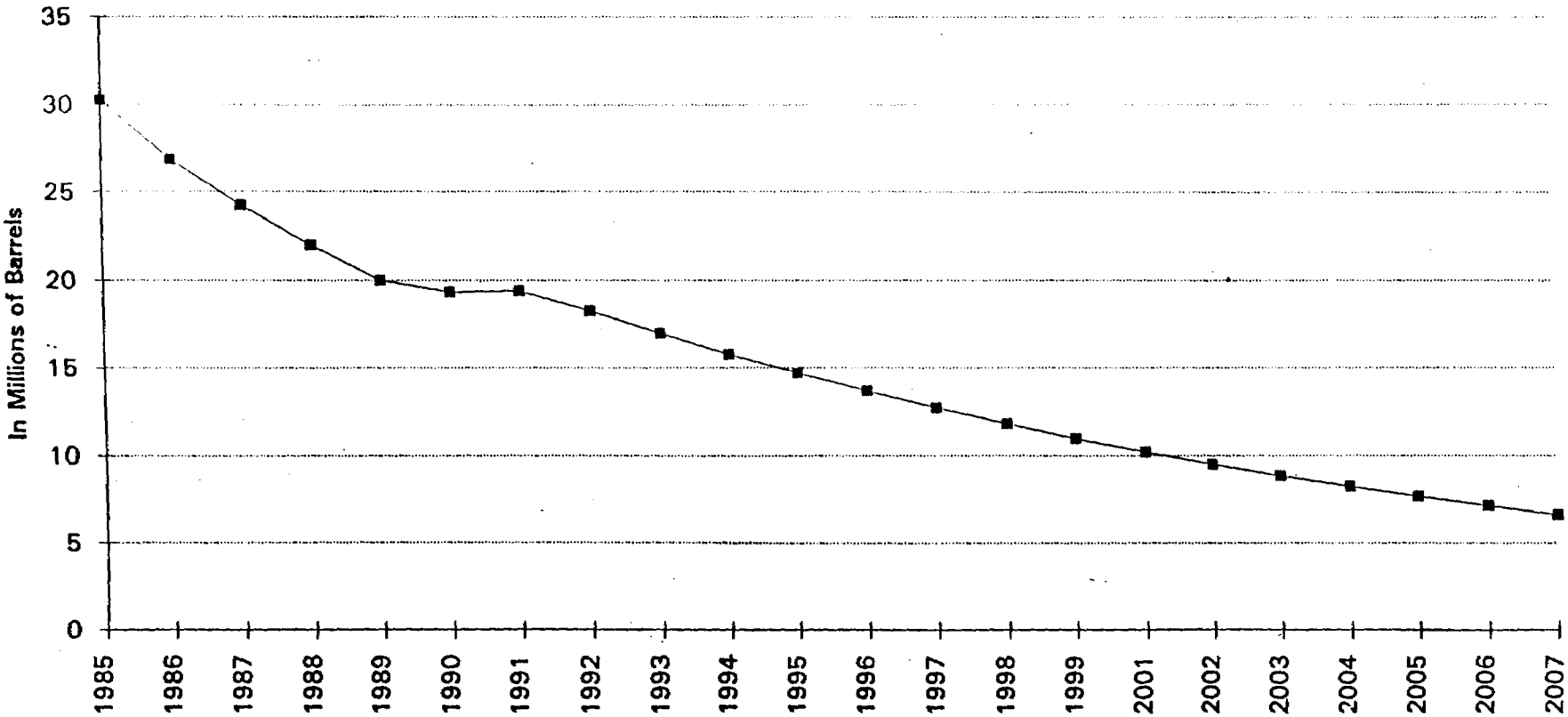


EXHIBIT 5
12-2-93
SB 18

MONTANA OIL PRODUCTION DECLINE PROJECTION



A PROPOSAL FOR MONTANA

- An extension of the current Net Proceeds Tax holiday from 12 to 18 months for horizontal well production from wells drilled after January 1, 1994. This incentive would encourage the drilling of these very expensive and risky wells. New vertical wells drilled after January 1, 1994, would continue to receive the current 12 month holiday.

- A reduction in the Local Government Severance Tax rate or the Net Proceeds Tax, whichever is applicable from 8.4% or 7%, respectively, to 5.0% on the incremental increase in production from new or expanded secondary recovery projects effective January 1, 1994, and a reduction in the State Severance Tax from 5.0% to 3.0% on this production.

- A reduction in the Local Government Severance Tax rate or the Net Proceeds Tax rate, whichever is applicable, from 5.0% or 7%, respectively, to 3.30% on the incremental increase in production from new or expanded tertiary recovery projects effective January 1, 1994, and a reduction in the State Severance Tax from 2.5% to 2.0% on this production.

EXHIBIT 5
12-2-93
SB 18

Montana tax rates on OIL production:

	From wells drilled prior to July 1, 1985		From wells drilled after to July 1, 1985	
	CURRENT	PROPOSED	CURRENT	PROPOSED
Severance	5.00%	5.00%	5.00%	5.00%
Secondary	5.00%	3.00% *	5.00%	3.00% *
Tertiary	2.50%	2.00% *	2.50%	2.00% *
RITT	0.50%	0.50%	0.50%	0.50%
Privilege & License	0.20%	0.20%	0.20%	0.20%
LGST	8.40%	8.40%		
Secondary	8.40%	5.00% *		
Tertiary	5.00%	3.30% *		
Strippers	5.00%	5.00%		
Non-working int.	12.50%	12.50%		
Net Proceeds **			7.00%	7.00%
Secondary			7.00%	5.00% *
Tertiary			7.00%	3.30% *
TOTALS (working int.)				
Oil: Regular	14.10%	14.10%	12.70%	12.70%
Secondary	14.10%	8.70% *	12.70%	8.70% *
Tertiary	8.20%	6.00% *	10.20%	6.00% *
Stripper	10.70%	10.70%	12.70%	12.70%
All new wells:				
First 12 months of production, total rate:			5.70%	5.70%
Subsequent production, total tax rate:			12.70%	12.70%
New horizontal wells				
Months 13-18 of production, total rate:			12.70%	5.70% *
Subsequent production, total tax rate:			12.70%	12.70%

Tribal royalties are exempt from taxation.

This chart does NOT include the various 7% surtax approved by the 1992 special session. The surtax applies to state severance, LGST, RITT and privilege and license taxes for one year of production. The production year and tax year varies with each tax.

* Denotes change from current

** The net proceeds tax on post-1985 wells is actually a flat rate on gross, but is still codified as net proceeds. New wells receive holiday from net proceeds tax for initial production as follows:
a. first 12 months for conventional vertical completions
b. first 18 months for horizontal completions

MONTANA

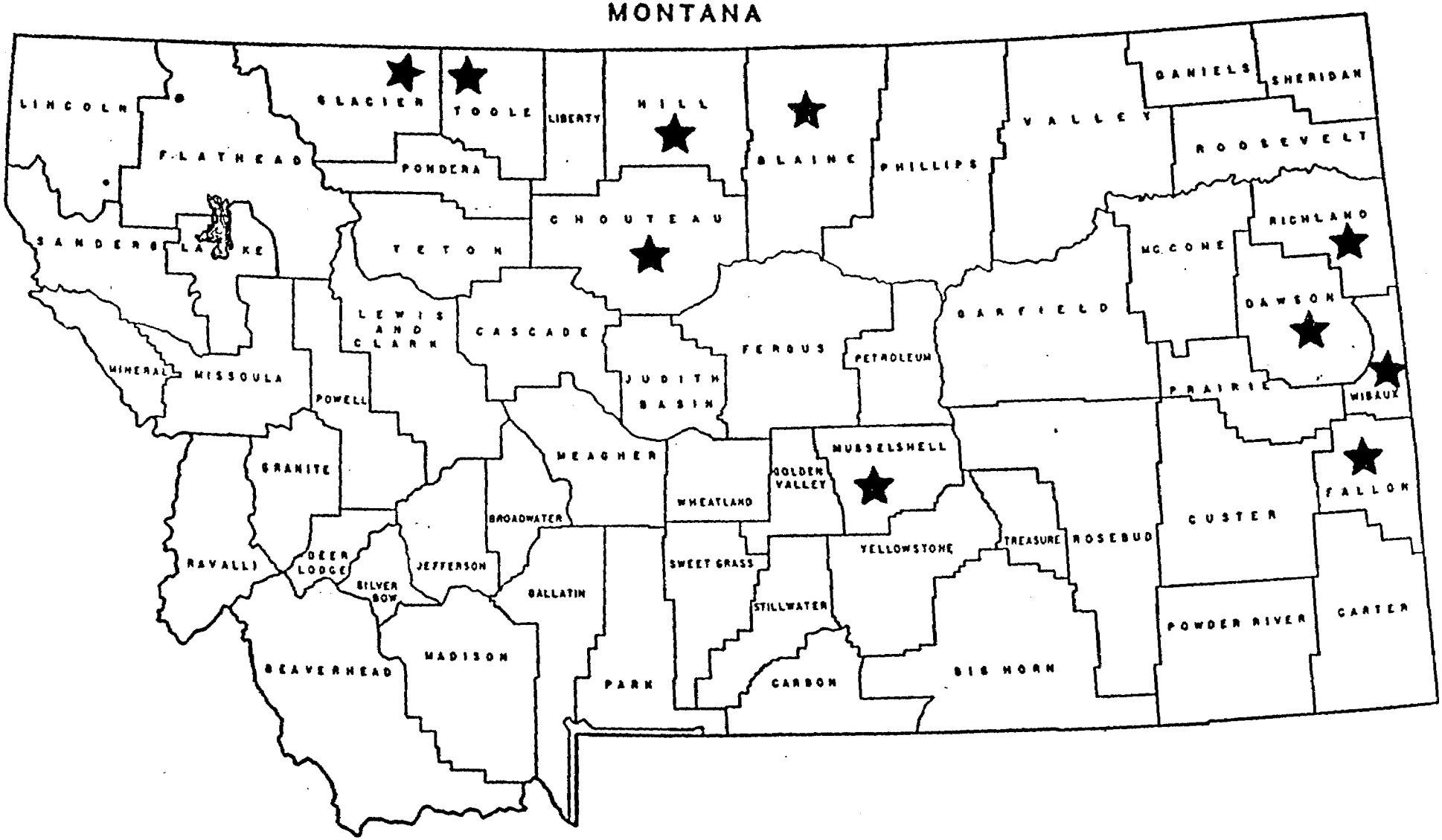

LINCOLN
FLATHEAD
GLACIER
TOOLE
LIBERTY
HILL
BLAINE
PHILLIPS
VALLEY
DANIELS
SHERIDAN
ROOSEVELT
PONDERA
CHOUTEAU
SANDERS
LAKE
TETON
MCCONE
RICHLAND
GARFIELD
DAWSON
LEWIS AND CLARK
CASCADE
FERGUS
PETROLEUM
MINERAL
MISSOULA
POWELL
JUDITH BASIN
PRAIRIE
WIBAUX
GRANITE
MEAGHER
MUSSELSHELL
GOLDEN VALLEY
WHEATLAND
FALLON
BROADWATER
CUSTER
RAVALLI
DEER LODGE
JEFFERSON
SILVER BOW
GALLATIN
SWEET GRASS
YELLOWSTONE
TREASURE
ROSEBUD
STILLWATER
POWDER RIVER
CARTER
BEAVERHEAD
MADISON
PARK
CARBON
BIG HORN

EXHIBIT 2
12-2-93
SB 18

COMBINED
MERIDIAN OIL INC. and
SHELL WESTERN E & P

MONTANA
PROPOSED CAPITAL DEVELOPMENT
AND
PROJECTED WELL COMPLETIONS

YEAR	INVESTMENT ($ MILLIONS)	# WELLS COMPLETIONS
1994	$ 22.450	22
1995	36.150	35
1996	30.750	31
1997	28.500	28
1998	23.500	22
	$ 141.350	138

ANNUAL PROJECTED INCREASED REVENUES FROM PROPOSED INCENTIVES

Year	State Taxes	Royalties	Local Taxes	Total
1994	$507,562	$120,088	$259,225	$886,875
1995	$1,261,036	$417,273	$738,229	$2,416,538
1996	$1,978,075	$739,284	$1,547,693	$4,265,052
1997	$2,578,146	$1,019,929	$2,326,625	$5,924,700
1998	$3,057,702	$1,216,401	$2,977,044	$7,251,147
1999	$3,087,210	$1,158,280	$3,598,782	$7,844,272
2000	$2,846,699	$1,020,804	$3,729,774	$7,597,277
2001	$2,684,843	$945,100	$3,516,449	$7,146,392
2002	$2,559,730	$897,074	$3,352,432	$6,809,236
2003	$2,457,185	$865,081	$3,216,195	$6,538,461
2004	$2,366,215	$843,472	$3,061,656	$6,271,343
2005	$2,261,140	$828,439	$2,960,025	$6,049,604
2006	$2,189,991	$817,122	$2,726,748	$5,733,861
2007	$2,019,209	$807,569	$2,644,831	$5,471,609
2008	$1,918,397	$798,133	$2,504,057	$5,220,587
2009	$1,657,331	$760,226	$2,161,212	$4,578,769
2010	$1,360,131	$722,125	$1,802,620	$3,884,876
2011	$1,102,545	$685,931	$1,468,421	$3,256,897
2012	$874,211	$651,552	$1,172,906	$2,698,669
2013	$779,232	$618,901	$1,048,532	$2,446,665
2014	$739,247	$587,891	$1,046,348	$2,373,486
2016	$739,457	$558,430	$984,809	$2,282,696
2018	$774,181	$583,494	$1,033,707	$2,391,382
2020	$839,665	$655,161	$1,123,876	$2,618,702
2022	$891,893	$713,379	$1,195,909	$2,801,181
2024	$894,348	$734,024	$1,162,628	$2,791,000
2026	$755,129	$645,624	$1,006,548	$2,407,301
2028	$506,250	$433,156	$684,122	$1,623,528
2030	$290,968	$241,448	$393,201	$925,617
2032	$104,343	$81,350	$141,005	$326,698
Total	$46,082,071	$21,166,741	$55,585,609	$122,834,421

EXHIBIT
12-2-93
SB 18

SUMMARY

- NO DECREASE IN TAX REVENUES FROM PRESENT OR FUTURE PRODUCTION ON EXISTING WELLS

- TAX INCENTIVES APPLY ONLY TO NEW OR ENHANCED PRODUCTION FROM NEW CAPITAL INVESTMENT AFTER DECEMBER 31, 1993 AND BEFORE JANUARY 1, 2002

- APPROXIMATELY 138 NEW WELLS WITH OVER $140 MILLION IN CAPITAL INVESTMENT

- NEW STATE AND LOCAL TAX REVENUES IN EXCESS OF $122 MILLION OVER LIFE OF NEW WELLS

EXHIBIT 5
12-2-93
SB 18

- **INCREASE "TAX HOLIDAY" ON HORIZONTAL WELLS FROM 12 TO 18 MONTHS**

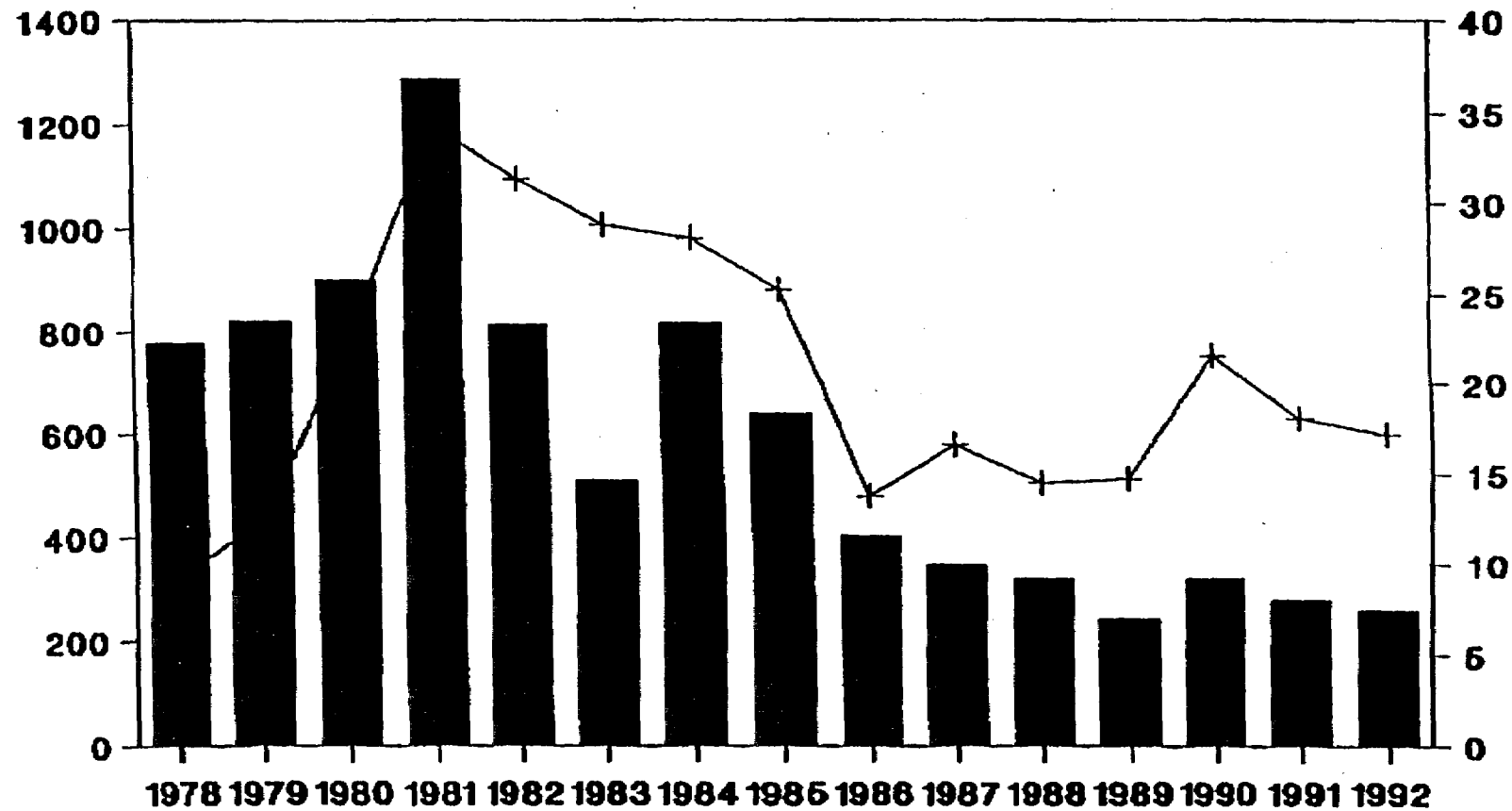
- **REDUCTION IN TAX RATES FOR NEW AND ENHANCED SECONDARY RECOVERY**

- **REDUCTION IN TAX RATES FOR NEW AND ENHANCED TERTIARY PRODUCTION**

12-2-93
SB 18

SENATE TAXATION
EXHIBIT NO. 6
DATE December 2, 1993
BILL NO SB 18

Montana Oil Prices/Wells Drilled
1978 to 1992



Produced by MPA, August, 1993

EXHIBIT 4
12-2-93
SB 18

MONTANA OIL PRICES AND NUMBER OF WELLS DRILLED
1978 TO 1992

Number of Wells Drilled in Montana

Year	Number of Wells Drilled
1978	778
1979	822
1980	902
1981	1,289
1982	816
1983	511
1984	819
1985	640
1986	405
1987	348
1988	322
1989	242
1990	322
1991	278
1992	259

Oil Wellhead Price

Year	$/BBL
1978	9.253
1979	12.279
1980	22.250
1981	34.317
1982	31.311
1983	28.804
1984	28.068
1985	25.214
1986	13.734
1987	16.622
1988	14.500
1989	14.710
1990	21.530
1991	18.10
1992	17.20

Production and price statistics from Montana Department of Revenue. Produced by Montana Petroleum Association, August, 1993.

EXHIBIT 1
12-2-93
SB 18

Meridian Oil Inc.

Presentation to the Montana Legislature

1993 Special Legislative Session

)leased to be with you today to discuss two topics: First, I want to explain to you the technology and risks associated with)ntal drilling, a technology in which Meridian has been (and continues to be) an industry leader. Hopefully, you may better stand why my company believes that an extension of the "tax holiday" for new horizontal wells is justified. Second, I want to with you some of our plans for new drilling activity in Montana that we anticipate will occur if the Legislature passes the ives for new and enhanced oil production.

an believes that these incentives will encourage capital spending, will increase production and will increase revenues for the)f Montana.

an is an active Montana producer and we are currently the largest independent oil and gas company in the United States in of total domestic proven reserves (of 6 Trillion Cubic Feet Equivalent - TCFE).

MERIDIAN OIL
DENVER REGION

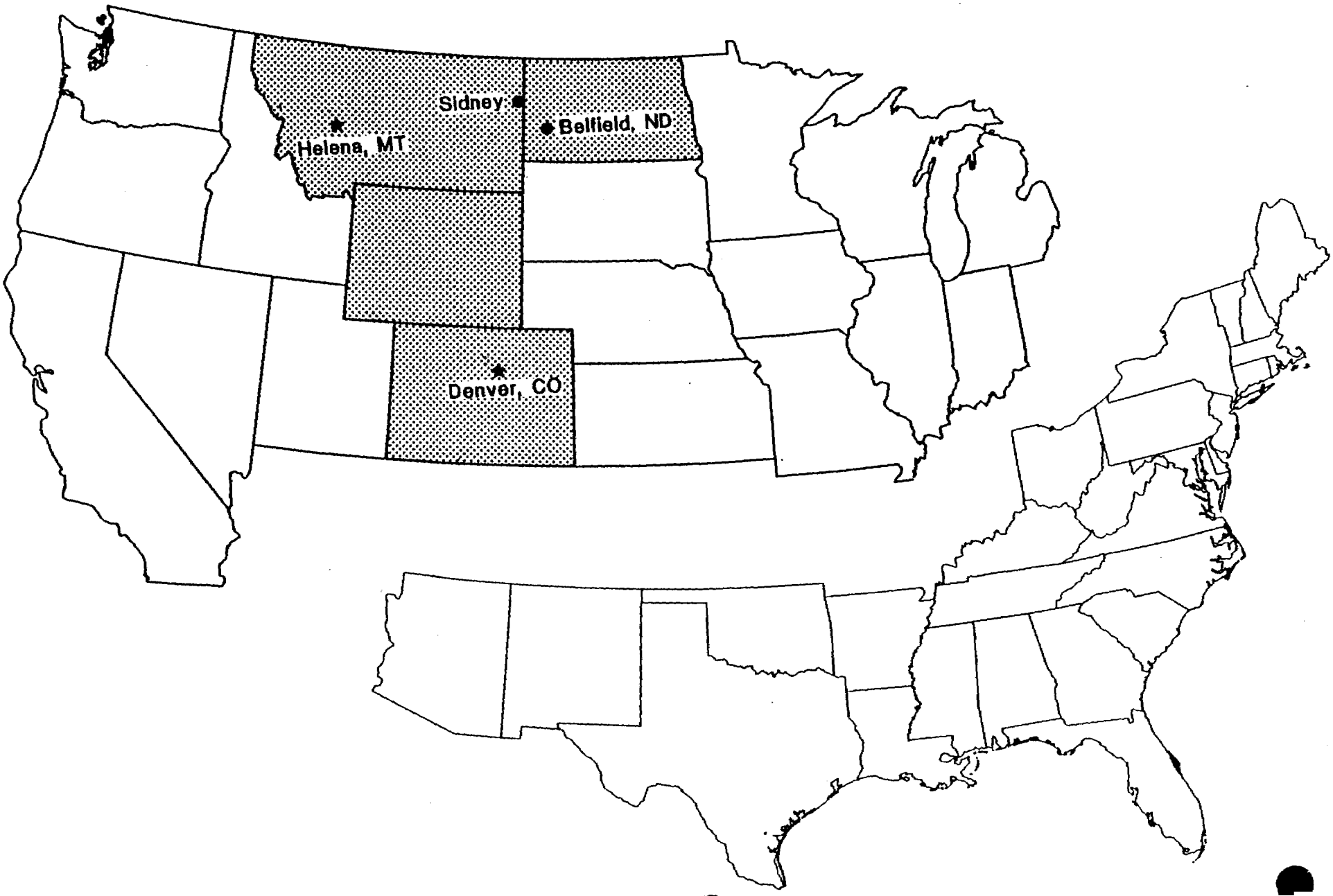


Exhibit 1 shows Meridian's Denver Region, which covers a large geographic area from Indiana to the West Coast. However, our historical focus has been in the Rocky Mountain area. Four states, North Dakota, Wyoming, Montana and Colorado account for 93% of our 15,500 barrels of oil and 28 million cubic feet of gas production per day. Additionally, over $41 MM or 95% of our Region's 1993 capital program will be employed in these states.

Our Production offices responsible for the operation of our Montana and North Dakota properties are located (as shown) in Sidney, Montana and Belfield, North Dakota. Upon completion of our 1993 drilling program, we will have drilled 34 new wells in the Sidney-Belfield area. Seven of these are located in Montana. 27 are located in North Dakota.

Three/fourths of our 1993 Sidney-Belfield wells will be drilled horizontally, with 7 out of the total 25 horizontal wells located in a pilot project in Montana.

We have requested that our Board of Directors approve increased levels of capital throughout the Denver Region for 1994. If approved, this would result in a 50% increase over our current year budget. We have proposed 51 new wells (as compared to the 34 in 1993) in the Sidney-Belfield area. We maintain the ability to reallocate capital within this area, as well as throughout the Denver Region, based on the relative economic success of the wells.

MERIDIAN OIL
DENVER REGION
HORIZONTAL vs. VERTICAL

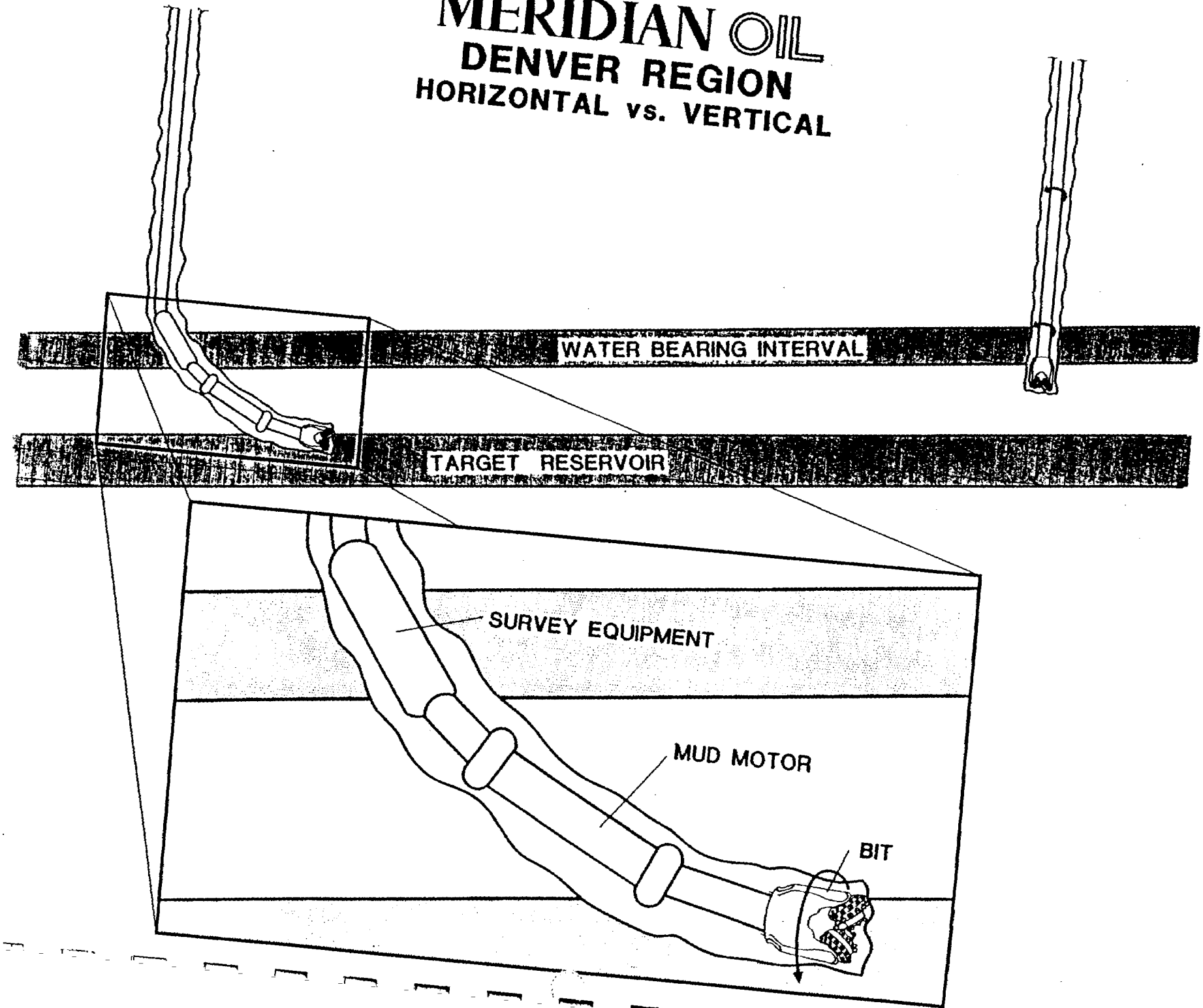


EXHIBIT 2,

I would like to now discuss some of the specifics of horizontal drilling and explain why the application of this technology is both more expensive and more risky than traditional vertical well drilling. The second exhibit depicts a horizontal well drilled in an oil or gas reservoir and a well drilled vertically through the same zone.

The exhibit shows that the downhole equipment utilized to drill a vertical well consists of straight steel tools that simply provide the necessary weight for the bit to drill. The entire drill string is rotated from the surface and the bit "naturally" drills vertically.

Drilling horizontally requires that the bit be "steered" into the target reservoir. The process requires downhole tools to continuously survey the location of the bit and the path of the wellbore. The horizontal bottom-hole drilling assembly also contains a bend. A downhole motor, located below this bend, is required to rotate the bit. Although I have greatly simplified the downhole tool description, this basic design allows us to "steer" the bit in the objective reservoir.

MERIDIAN OIL
DENVER REGION
HORIZONTAL vs. VERTICAL

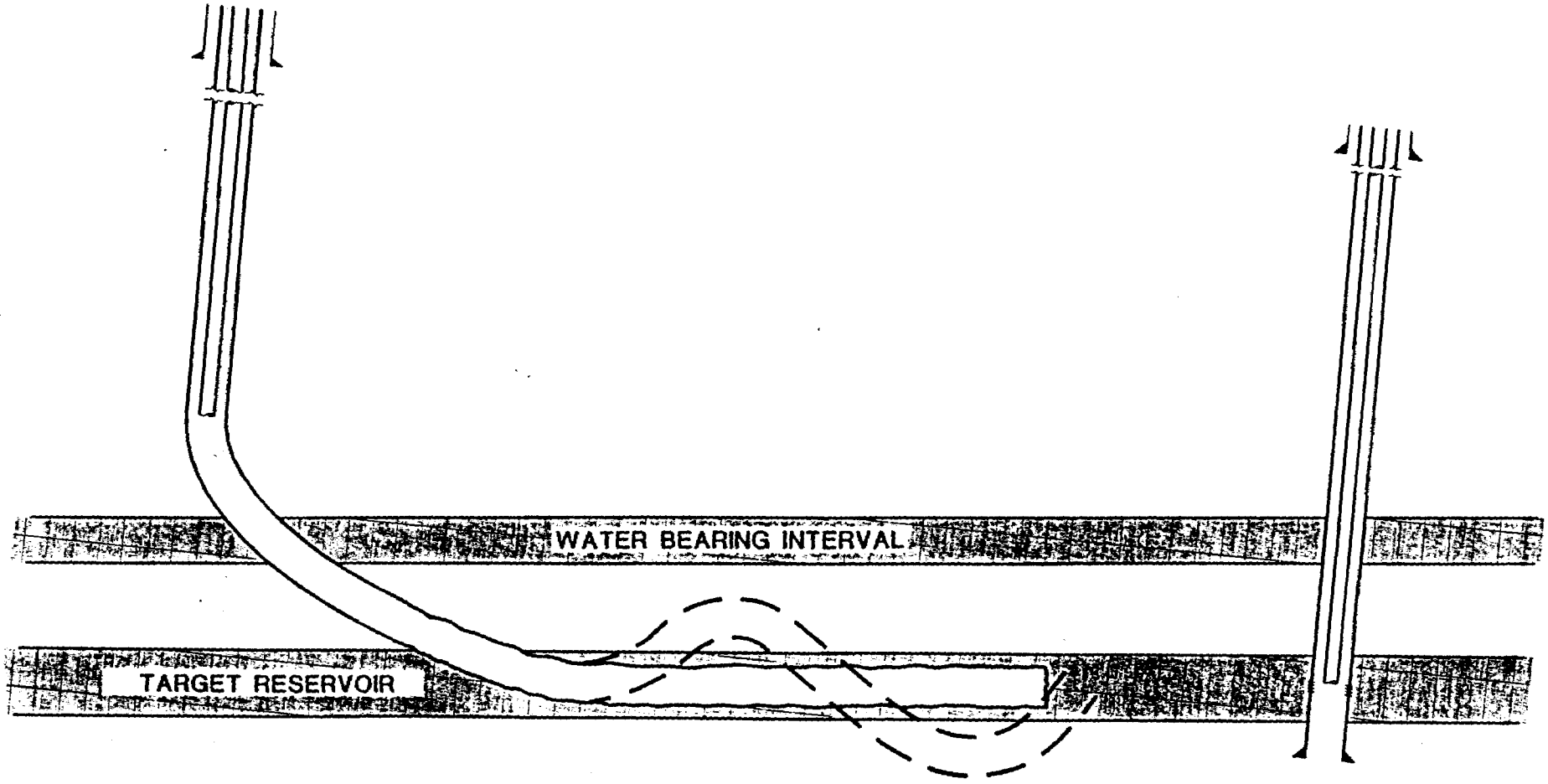


EXHIBIT 3

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MERIDIAN OIL
DENVER REGION
HORIZONTAL vs. VERTICAL

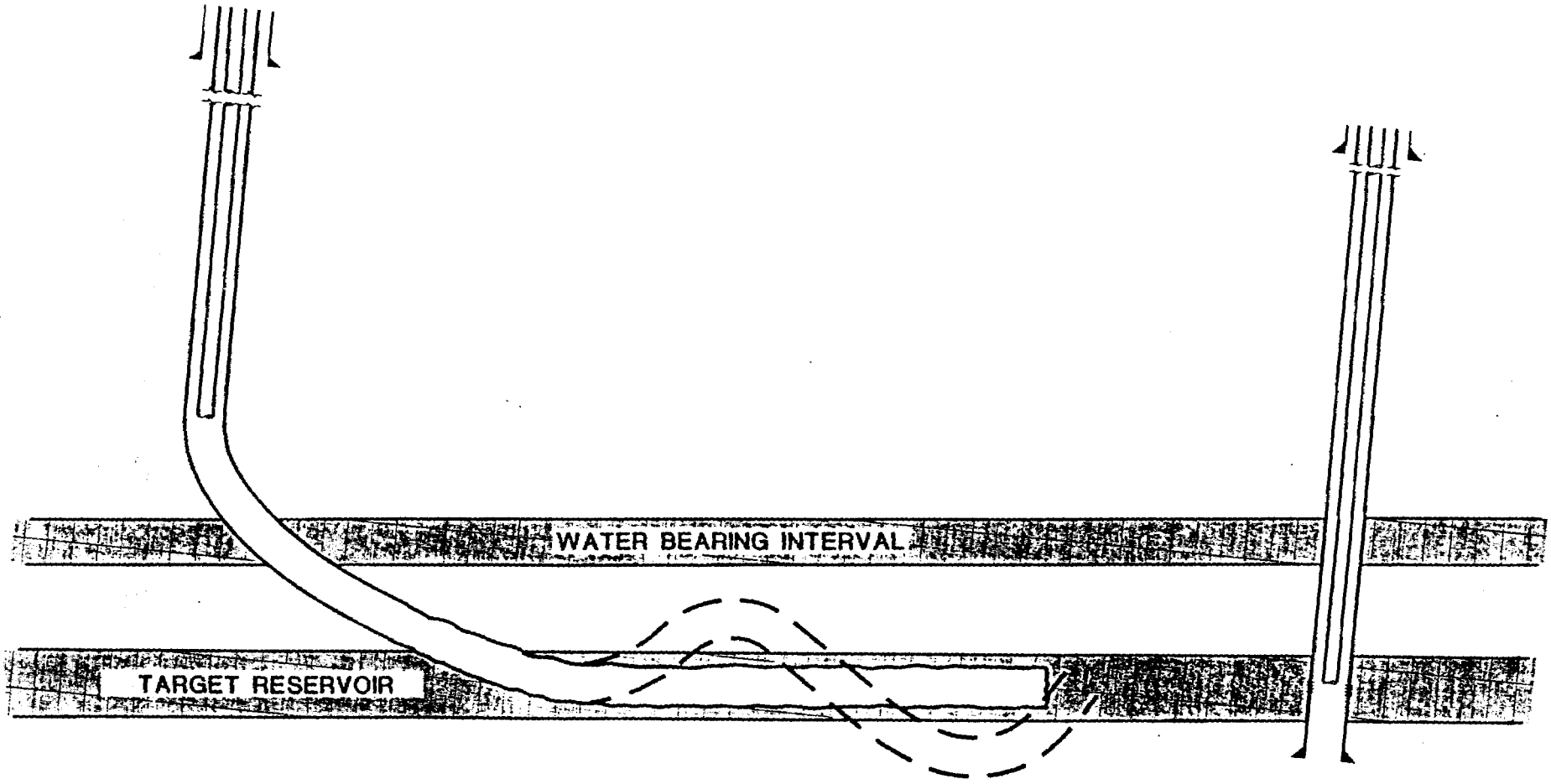

EXHIBIT 3

EXHIBIT
12-2-93
SB 18

he challenges associated with horizontal projects are great. Reservoirs must be accurately mapped in order to both hit the bjective formation and to remain in the targeted zone. As diagrammed in Exhibit 3, drilling "in zone" is particularly difficult in thin :servoirs of less than 5-10'. Once in the horizontal portion of the wellbore, there remains a higher probability that the costly bottom ɔle drilling assemblies will be stuck or even lost in the hole. Open-hole logging procedures are more complicated since the reline conveyed tools will not gravity fall to the end of a horizontal wellbore.

; an example, I would like to review the problems that we experienced while drilling a horizontal well in 1988 in southeast ɔntana. The downhole tools became stuck while drilling in the horizontal portion of the wellbore. Seven days were lost attempting recover the stuck tools, setting a cement plug and drilling around the lost tools. The total cost of the problem exceeded $350M, ich included $200M for the lost downhole equipment. These costs are significant when you consider that the cost of a problem- e well in this area is approximately $1MM.

e technical challenges are not unique to the drilling operations. Difficulties are frequently encountered during the completion and duction phase of the horizontal projects. Problems are commonly associated with running and cementing production casing, forating the casing, stimulating the reservoir and (like in the open hole case) conducting logging operations.

Industry reports of the increased time and cost of these procedures vary widely. Costs of 2-3 times that of offset vertical wells have been reported. We have been drilling horizontal wells in the Meridian Denver Region since 1987. Our experience has demonstrated that drilling wells horizontally as opposed to vertically results in:

50% to 100% increase in our daily drilling cost

50% to 100% additional drilling time - and -

25% to 50% of additional footage drilled in the horizontal portion of the wellbore.

In spite of these higher costs, the industry has attempted horizontal wells worldwide in a variety of oil and gas reservoirs. The economic viability of the projects has also varied significantly. A number of horizontal attempts have been economic failures.

MERIDIAN OIL

DENVER REGION

FIVE YEAR IMPACT

— DRILL 107 WELLS

— CAPITAL COST $113 MM

— MINIMUM 2 RIGS OPERATING

— $3.4 MM/YEAR TO 88 DIRECT EMPLOYEES

— 350 ADDITIONAL JOBS

I would now like to discuss our proposed Montana drilling program to demonstrate both the risk and extent of what we are currently considering. I will focus on our East Lookout Butte horizontal pilot in southeast Montana. The project is near the Shell operated Pennel Unit on the east flank of the Cedar Creek anticline, as shown on Exhibit 4.

The project was initiated in 1988 when Meridian drilled 5 horizontal wells, attempting to achieve higher producing rates than the low rates of the existing vertical wells in the area. Even though higher rates were achieved, the wells were still marginally economic due the increased cost of the horizontal wells. In the same year, Meridian initiated a one year pilot water flood by injecting brine water into a single vertical well. We then requested and were granted extensions of the pilot water flood by the Board of Oil and Gas Conservation in 1989, 1990 and 1992. This project had been in a producing and evaluation phase then for 4 years until the beginning of 1993. This year, we expanded this pilot project by drilling 7 new horizontal wells.

We were able to justify these new wells primarily because of cost savings and efficiencies that we had gained from horizontal experience throughout our company during that 4 year period. The economic results of these 7 wells will impact our decision to move forward with the full project development of 70 wells in the East Lookout Butte project over the next 5 years. Due to current depressed oil price of less than $15/bbl in the area, these wells also appear marginally economic in spite of lower drilling costs than the 1988 program.

Again, the results of the horizontal drilling attempts industry-wide, throughout Meridian and in our East Lookout Butte project, all demonstrate the marginal economic nature of horizontal wells.

MERIDIAN OIL

DENVER REGION

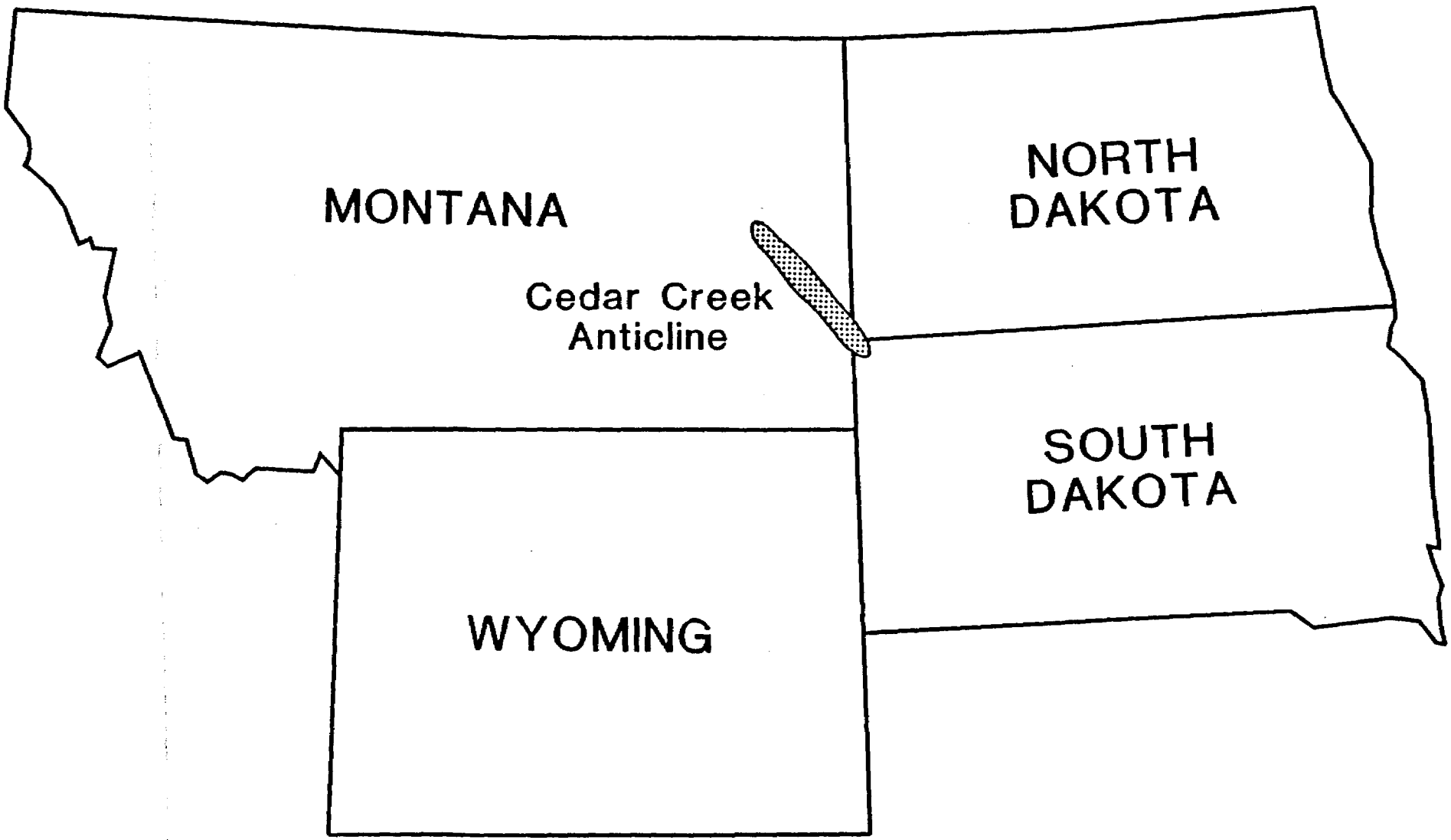

EXHIBIT 1
12-2-93
SB 18

Within Meridian, horizontal projects have experienced mixed economic results. As of August of this year, Meridian has drilled 218 horizontal wells. The wells were drilled in 22 pilot project areas, testing different geologic formations that produce both oil and natural gas.

In total, we consider the effort to be economically successful and we are quite pleased with our overall horizontal program. We can demonstrate this by pointing out that over 80% of these 218 horizontal wells have been drilled in the development of successful pilot programs. However, all these development wells were drilled in just 3 of the total 22 horizontal programs that have advanced beyond the pilot phase. The remaining 19 pilot projects, including our proposed Montana projects, are still in the evaluation stage and have not proven economically attractive enough to merit further development.

We feel that the mixed success rates reported by industry and these results within Meridian, demonstrate the marginal economic nature of most attempts at horizontal drilling. Therefore, any incentives to drill these risky and costly horizontal wells would be well received by the industry.

actors that effect the economics of horizontal projects are oil price, drilling and production costs, production rate and others such s the taxes that we are discussing today. Most of these variables are beyond our control. The proposed incentives, however, are ariables that the state can influence.

nplementing the proposed horizontal drilling and enhanced oil recovery incentives would positively impact the East Lookout Butte lot program, as well as the other Montana projects that Meridian has under consideration for 1994 and succeeding years. The conomics of horizontal wells drilled in the area would be improved to the point that the project would compete favorably for capital ith other projects within the Denver Region and throughout Meridian.

ovided that we are able to economically justify moving forward on this and other similar projects, we estimate that Meridian could ill up to 107 wells in the State of Montana over the next 5 years at a capital cost in excess of $113 MM. With an average of 44 ect employees per drilling operation and with at least 2 drilling rigs operating full time for the next five years, we believe that the illing activity alone will substantially add to the Montana economy. We estimate that annual salaries of approximately $3.4 MM r year would be paid to approximately 88 employees directly supporting the 2 drilling operations. Further, based on a 4:1 ratio of direct to direct employment, we estimate that over 350 additional support jobs would be needed in surrounding communities.

EXHIBIT 1
12-2-93
SB 18

I encourage you to strongly consider the proposed incentives for horizontal drilling and enhanced oil recovery projects. I believe that the incentives will serve to induce new, significant capital spending in Montana and will ultimately result in increased production and increased revenues for the state.

I appreciate the opportunity to discuss these issues with you and I welcome any questions that you may have for me today.

TESTIMONY OF R. E. SHEFFIELD

SHELL WESTERN E&P INC., HOUSTON, TX

IN SUPPORT OF LEGISLATION TO ENCOURAGE

HORIZONTAL DRILLING AND ENHANCED OIL PRODUCTION

SENATE TAXATION
EXHIBIT NO. 8a
DATE December 2, 1993
BILL NO. SB 18

My name is Bob Sheffield. I am Western Asset Technical Manager for Shell Western E & P Inc., based in Houston, Texas. SWEPI, as we are sometimes called, explores for and produces oil and gas in the US. We have operations stretching from Florida to Alaska. My territory in the Western Asset stretches from West Texas and New Mexico up the Rockies to Montana and on into Alaska. In my position I am responsible for technical review of all new projects and preparation of our capital budgets.

Shell is the largest oil producer in Montana, accounting for about 30 percent of the 20 million barrels produced here every year. We first discovered oil in Montana in 1951 near Glendive. This is in what's known as the Cedar Creek Anticline, a prolific formation running nearly 100 miles from Glendive through Baker and across the state line down into North Dakota. At the height of our development, in the late 50s and early 60s, there were times that we had as many as 16 drilling rigs operating in our field in Eastern Montana. We had major offices in Billings and Glendive and five field offices. Production peaked in 1964 at 39,000 barrels of oil per day. At this time we had about 60 Shell employees in Montana and also employed several hundred contract service personnel. Although our oil production has been gradually declining, we

have been working hard to reduce this decline and prolong the productive life of the field.

Currently we produce more than 16,000 barrels of oil a day from 460 wells. We operate nearly 200 water injection wells, three gas conditioning facilities, and 50 field locations with a total investment of $350 million. We now have about 50 employees in Montana and pay $14 million a year in taxes. These tax payments have been steadily declining as our oil production has declined.

Although we pay a variety of taxes on our oil production, they basically work the same way. You take the tax rate and multiply it times our production volume and the price of crude oil. The combined Montana tax rate of about 12.7 percent is the highest oil and gas tax rate of any state that we operate in. The taxes we pay to Montana have been falling, because both our production volume and crude prices have been falling.

I would like to briefly discuss some basics of oil production, especially defining the waterfloods that we use extensively now in the Cedar Creek Anticline. The first phase of production is what we call Primary Production where we produce the oil with pumping units simply relying on the natural pressures of the formation. This continued for about 10 years in our field, and we were able to recover 15-20 percent of the oil originally inplace. Production would have declined rapidly and we would have sold or abandoned the field by now if we had not taken action to supplement natural reservoir pressures.

The action we took to stop the production decline was implementing Secondary Production, which in the case of this field is a waterflood. As the name implies, in this method we pump water back into the producing part of the field -- usually brine or salty water that is produced with the oil or from deep brackish formations. The water is pumped into the oil producing formation to help maintain the original pressure that drives the oil through the rocks to the producing wells.

It is very difficult to produce all of the oil in your existing formations. We have now been on Secondary Production for 30 years and have produced approximately 30 percent of the oil originally in place. We have invested $100 million in waterflood equipment, including pumps, flowlines, water handling and storage tanks, and a great deal of electrical equipment to keep it all working. Our electricity bill alone is about $400,000 a month! The added cost of a waterflood has to be justified by the added production you can get.

The third step in recovering additional oil is Tertiary Production. This is a much tougher economic decision. The oil left behind by the waterflood is the hardest to produce. In the mid '80s, we considered injecting CO2 into our formation. We actively lobbied this Legislature for tax incentives to make this economically feasible. We said at the time that the economic feasibility for this proposed project was based upon crude prices of $27 per barrel. The project was not carried out because shortly after the tax incentive was passed by the Legislature, oil prices plummeted drastically, to nearly $10 per barrel, making it economically impossible to carry out the project. CO2 is one of the most

widely used Tertiary Production techniques. Others include chemicals such as polymers and surfactants and even steam. In most cases, this third phase is significantly more expensive. At the current average price of $12.50 a barrel for Montana oil, it is very difficult to justify the investment required. However, there are some operators who are considering tertiary projects right now.

The oil industry has changed dramatically in the 40 years that Shell has been in Montana. During this time, the combination of the US government restricting exploration in many prime areas and this cost/price squeeze has forced many large US oil companies to look elsewhere for new opportunities. Many have taken their exploration efforts overseas. Those of us who remain dedicated to the US have had to work smarter. Yes, like many industries, we have had to trim costs, including laying off employees. My company has cut back over 20 percent in the last few years.

We have also invested heavily in new technology. First, most of our existing wells are all monitored electronically, so that we know exactly how each well is doing from a computer screen in the office. Next, we have taken the newest exploration tool -- three dimensional or 3D seismic -- and have used it extensively throughout the Cedar Creek Anticline. Much of this work was done in the late 80s. Now, we have interpreted that seismic and are attempting to further develop the area. For the past few years we have been drilling north of Baker in the Pine, Pennel and Cabin Creek areas.

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As we move southeast in the Pennel Unit, the rock quality tends to deteriorate, making oil production more difficult. This picture shows well density in our Pennel Unit. You can see more wells in the north and more open spaces in the south. As the rocks thin out in the south and east, we cannot justify the cost of the many traditional vertical wells it would take to produce this. So we have experimented with horizontal wells that, while much more expensive, could economically recover the oil in this poorer part of the field. To date, our tests have been encouraging.

Let me show you a simplified chart of our Cedar Creek Anticline and how it responds to the kind of expanded water flood we are discussing. This curve represents a normal production cycle, with production gradually falling off as years go by. The Cedar Creek Anticline is 40 years old and we are well into the later stages of production. The tax incentives we are proposing are to make expansion economically feasible. By drilling additional horizontal wells we plan to expand production and extend to life of this field. Without this additional investment, we expect this field to become uneconomic soon after the turn of the century. With this additional phase of investment, we think we can add another seven years to the field's life. Please note that the normal expected production, shown in blue, will be taxed at the current rates. It is only the incremental - or added production - shown here in red, that is taxed at the lower rates we are suggesting.

We are now prepared to move forward with a $25-30 million program of at least a dozen horizontal wells and perhaps 20 traditional vertical wells

over the next several years. If these are economically successful, we would probably find other locations in our field to drill horizontal wells in a second phase of this effort. We hope this first phase will add nearly 4,000 barrels of oil to our current daily production of 16,000 barrels and 11 million barrels to the ultimate recovery of this field. Over the next 15-20 years we estimate that this investment will generate $13-15 million in additional tax revenues to the state and local communities. That's new revenues above and beyond the taxes we pay on our current production. What's more, the tax incentives will help us extend the life of the field, which helps extend the jobs this field generates -- jobs for Shell employees and many others in the community.

We are currently evaluating the results from our second horizontal well, the total costs involved and the relative earning power of these wells as compared with other possible investment opportunities in other parts of my territory. When we first start in the budgeting process, there are always several "sure things" that are easy to approve. Then, as you review other projects you reach a group of investments that are closely competitive and "marginal" in a sense that they all just meet our investment criteria. These Montana wells are like that. They are sitting on an economic bubble, or the outer limits of our 1994 budget. By that I mean they are generally the most marginal of the many new projects that we are considering. However, when you factor in the new, lower taxes we are discussing, these projects improve their rate of return and "beat out" the other "marginal" projects.

So I am here today proposing that the State of Montana consider economic incentives for renewed investment in oil development. We have invested the time, technology and money to fully evaluate these prospects. We are asking the State of Montana to offer new, reduced tax rates on new investment only. (Remember, all of our existing production would continue to be taxed at the current higher rates.) In return for these tax incentives, we are prepared to invest heavily in Montana, bring more drilling jobs to the state, increase the life of our oil field and thereby prolong the duration of jobs at our field. Perhaps most importantly to you here, this project will generate additional tax revenues to the state and counties. What's more, it's not just Shell and Meridian, although we are clearly in the forefront and ready to commit large amounts of capital now. We have talked to numerous smaller oil companies who are also evaluating horizontal technology. Several have already drilled a few wells in Montana or are considering it. They are watching us here today. If we move forward together in a positive fashion, I think it is reasonable to expect others to invest in Montana.

I believe this as a solution that benefits everyone. There is no loss of tax revenue to the state, there is only increased revenue. We will invest capital and create jobs.

Some say the State doesn't need to "help" Shell because we will drill these wells anyway, even at the higher tax rates. Yes, we will probably drill some. But, returning to my investment example: At the old, higher tax rates, these Montana wells have strong competition for capital funds from other Shell projects. The lower tax rates give this project a

little breathing room to stay ahead of other projects. In the long run, that means we will be able to drill more wells in Montana, rather than curtailing our expansion before its completion.

The other question we have been asked repeatedly is "Why now? What's your hurry?" In other words, why can't this wait until the '95 Regular Legislative Session?

It is a necessity that we act now! Both Shell and Meridian have done their homework -- the seismic has been shot, its interpretation has been done, we have drilled a few horizontal wells to test our theory. In Shell's case, we have a mature field in a decline. With an aging field infrastructure and declining oil production, if we do not act now the field won't justify further investment. We are already at the point that many traditional vertical wells don't make economic sense. That is why we must drill the more expensive and riskier horizontal wells. To revive the field we need to act now. My department has the budget authority to move forward on the projects that meet our economic criteria. Before long, we will begin our 1995 planning cycle. If we wait until after your 1995 Regular Legislative Session, we will be working on our 1996 budget. If we delay this project, or only drill part of the first phase, we may lose the financing for the second phase to other areas. With production from the Cedar Creek Anticline otherwise declining rapidly, the economics may never again be favorable for further development with horizontal wells. Thus, if we are to take steps to maximize the production from our Montana holdings and also maximize the tax amounts that the State and local governments could receive, we must be able to act now. I view this

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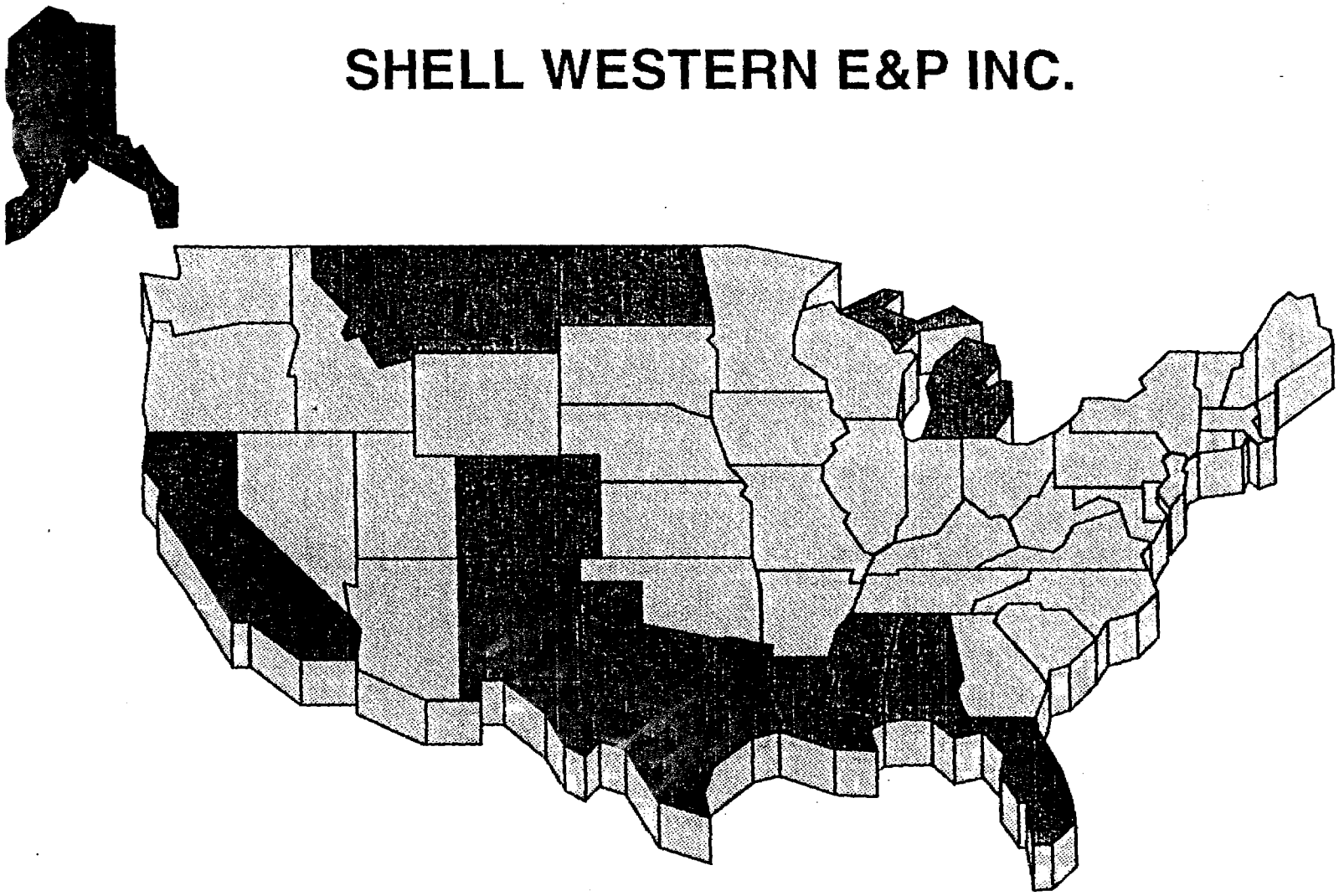
as a unique opportunity, timewise as well as opportunity wise. The time is now and we can move forward together.

Thank you for giving me the opportunity to speak today. I would be happy to address your questions.

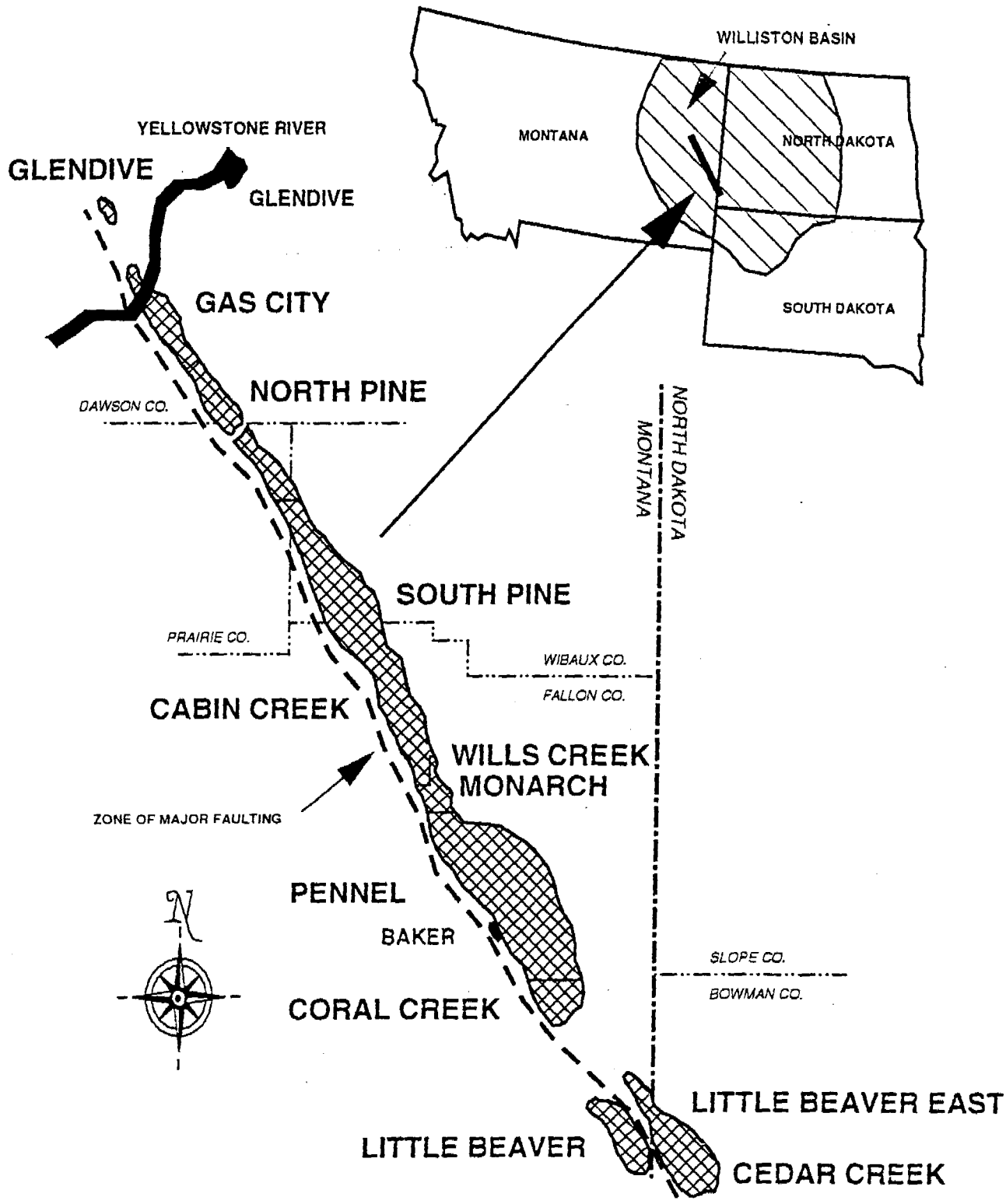
SHELL WESTERN E&P INC.



SENATE TAXATION
EXHIBIT NO. 2b
DATE January 23, 2013
BILL NO SB18

SWEPI..PPT:

CEDAR CREEK ANTICLINE



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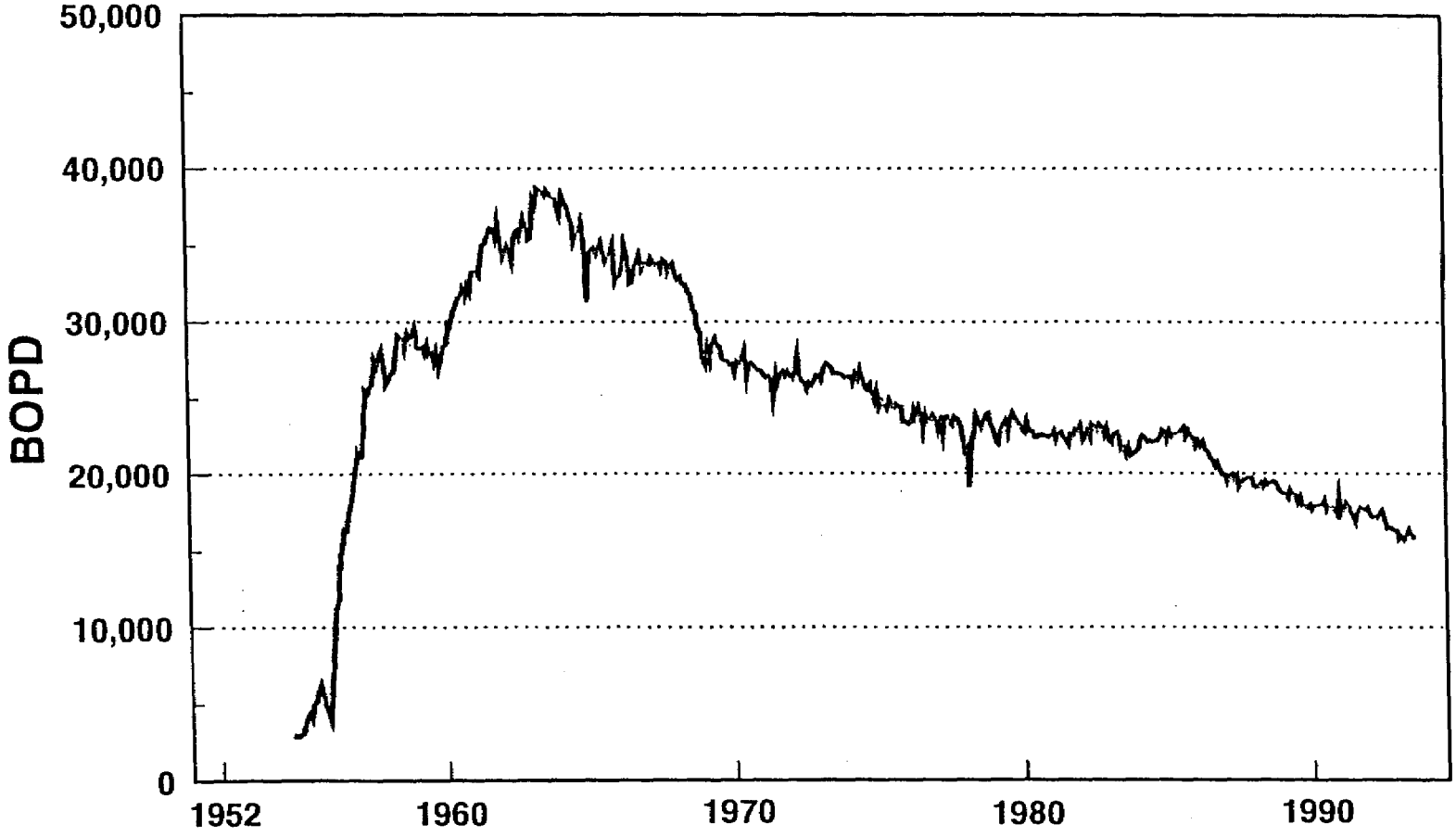
CEDAR CREEK ANTICLINE

OIL PRODUCTION



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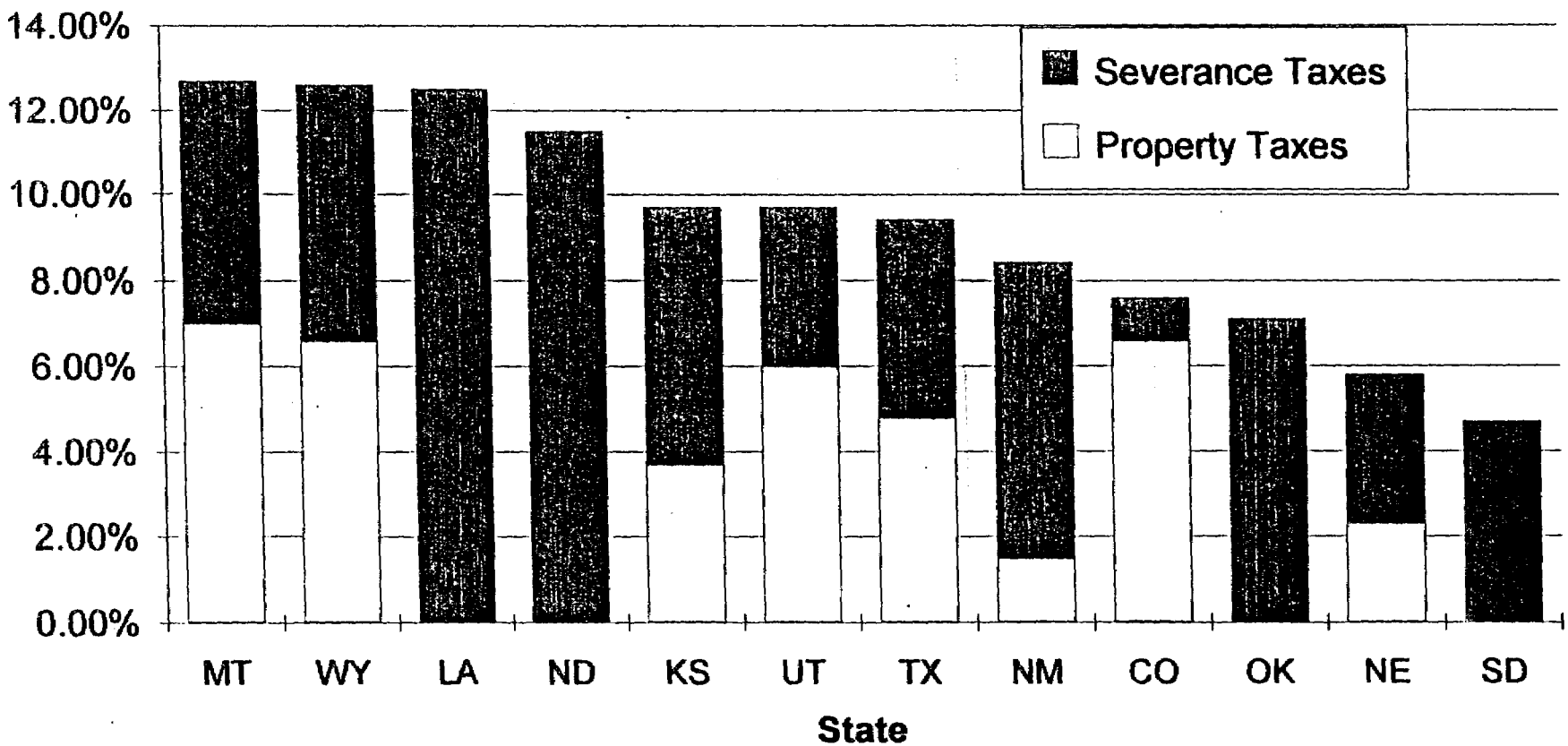
Composite Effective Tax Rates on Crude Oil



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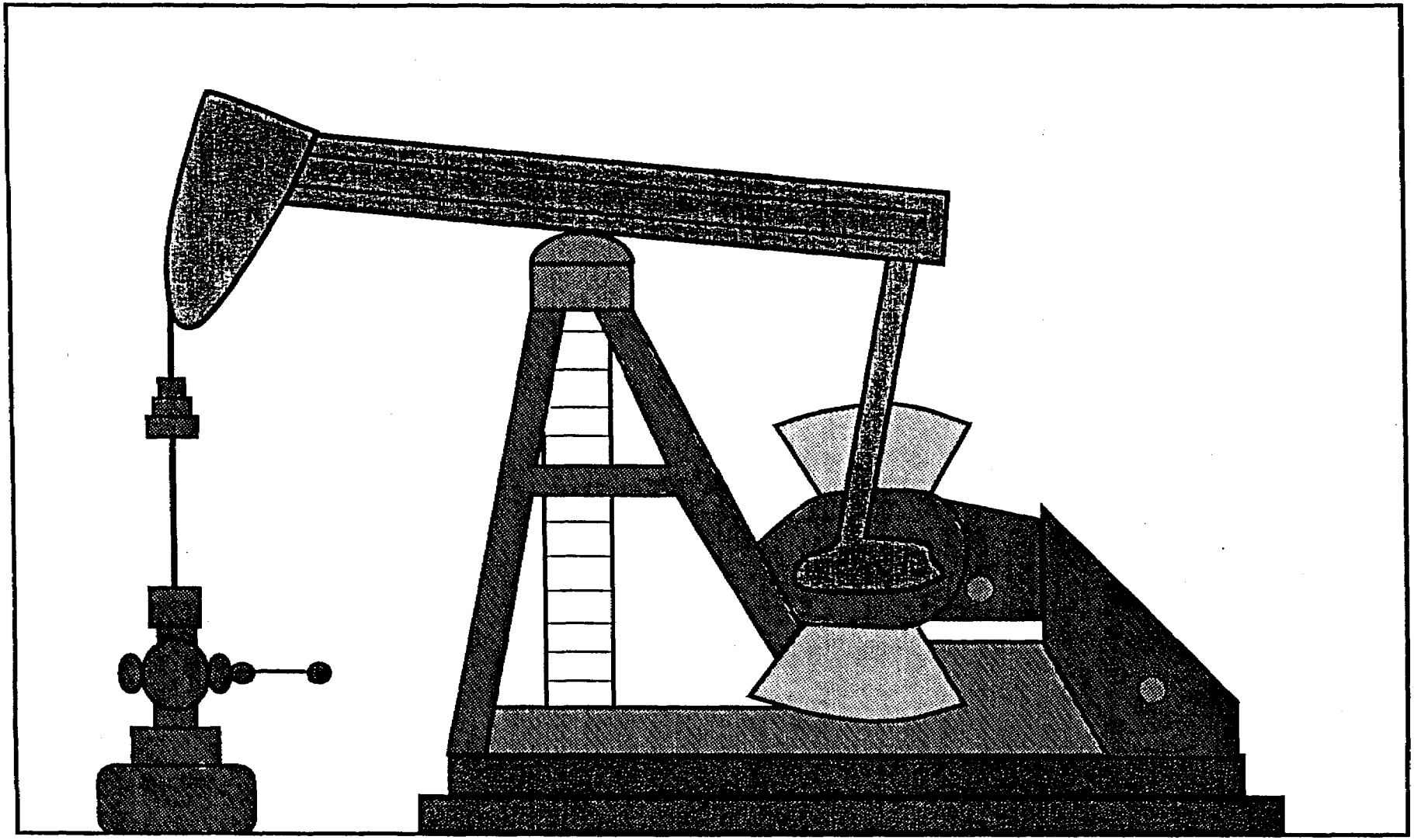
Pumping Unit



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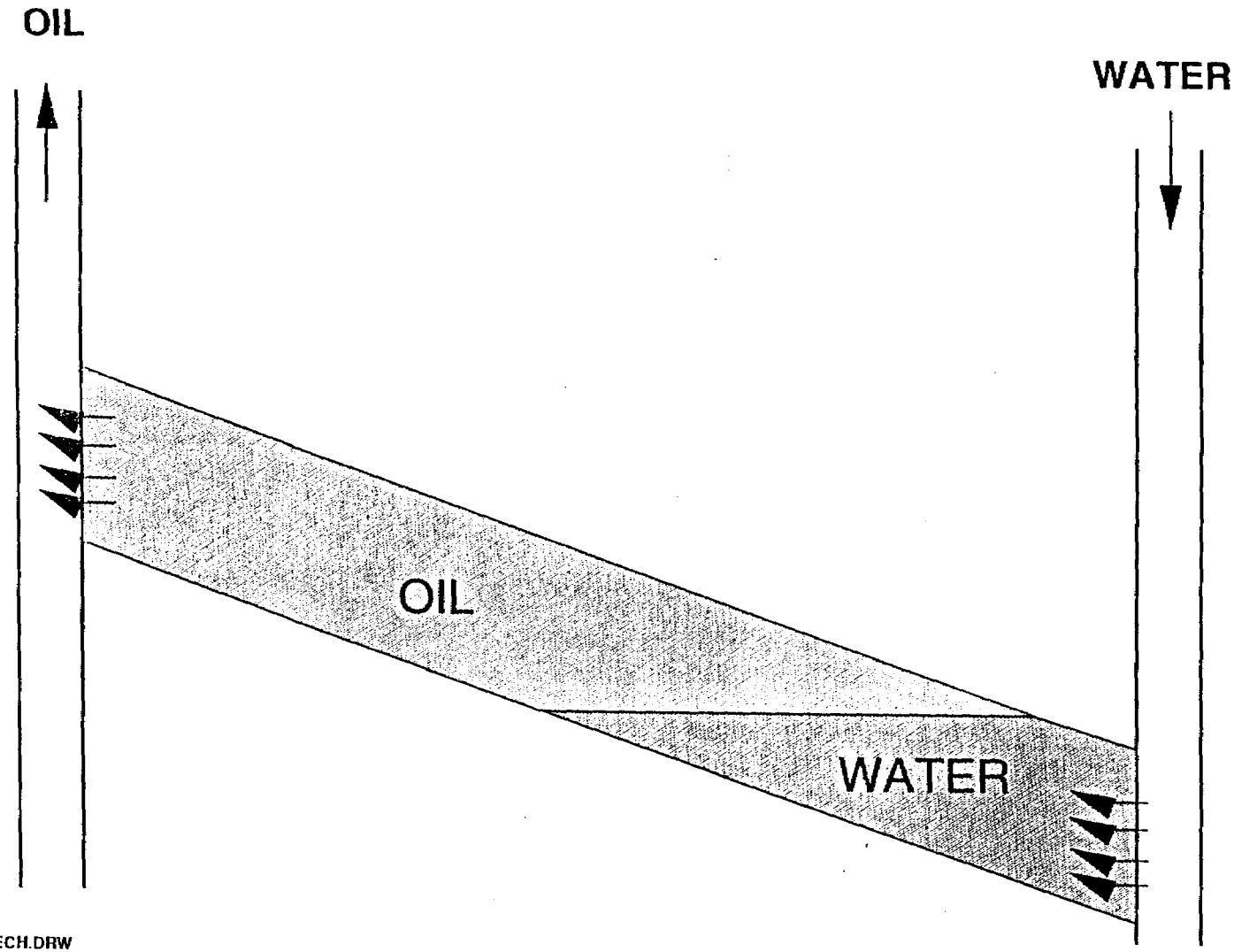
CEDAR CREEK ANTICLINE
WATERFLOODING TECHNIQUE



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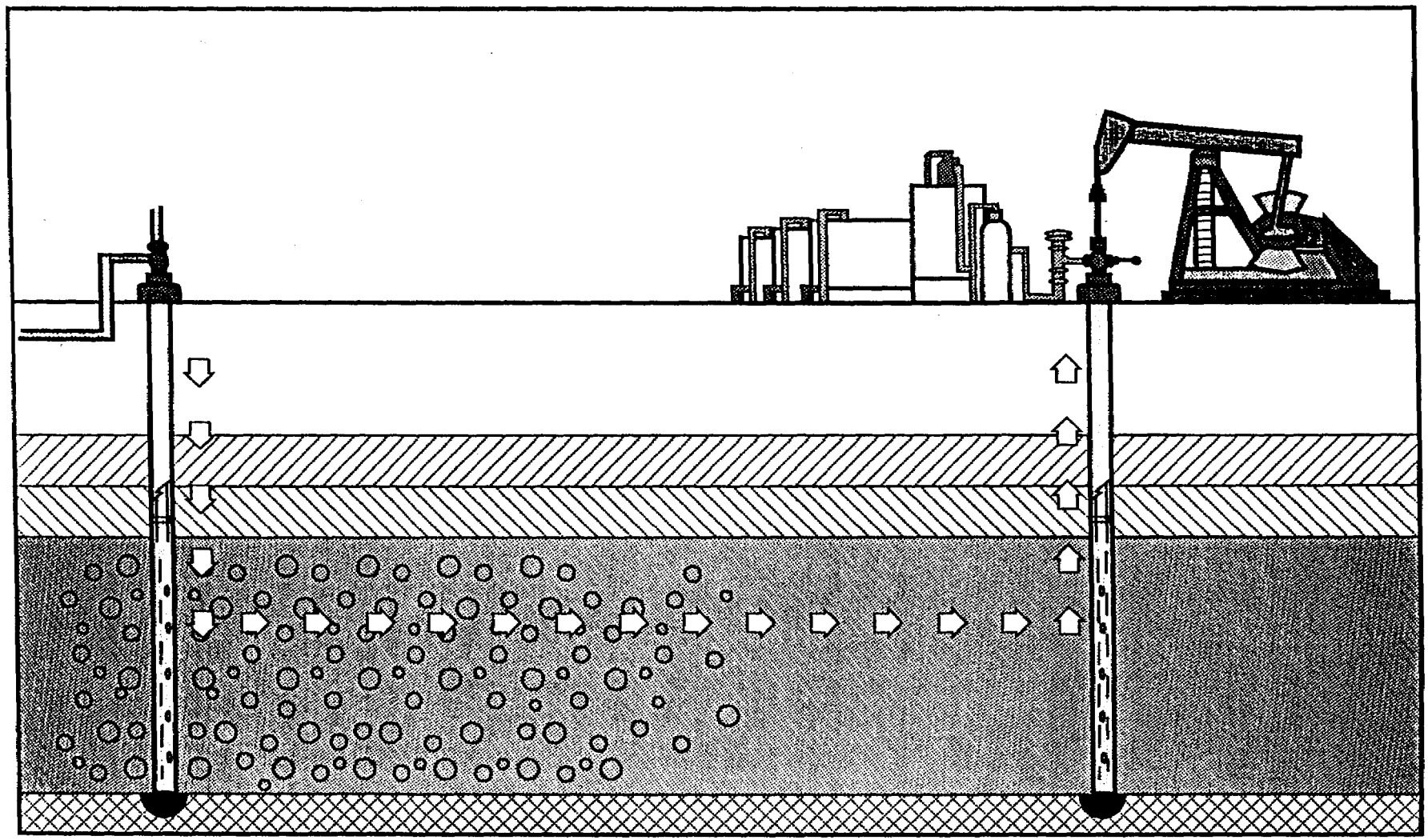
Tertiary Production



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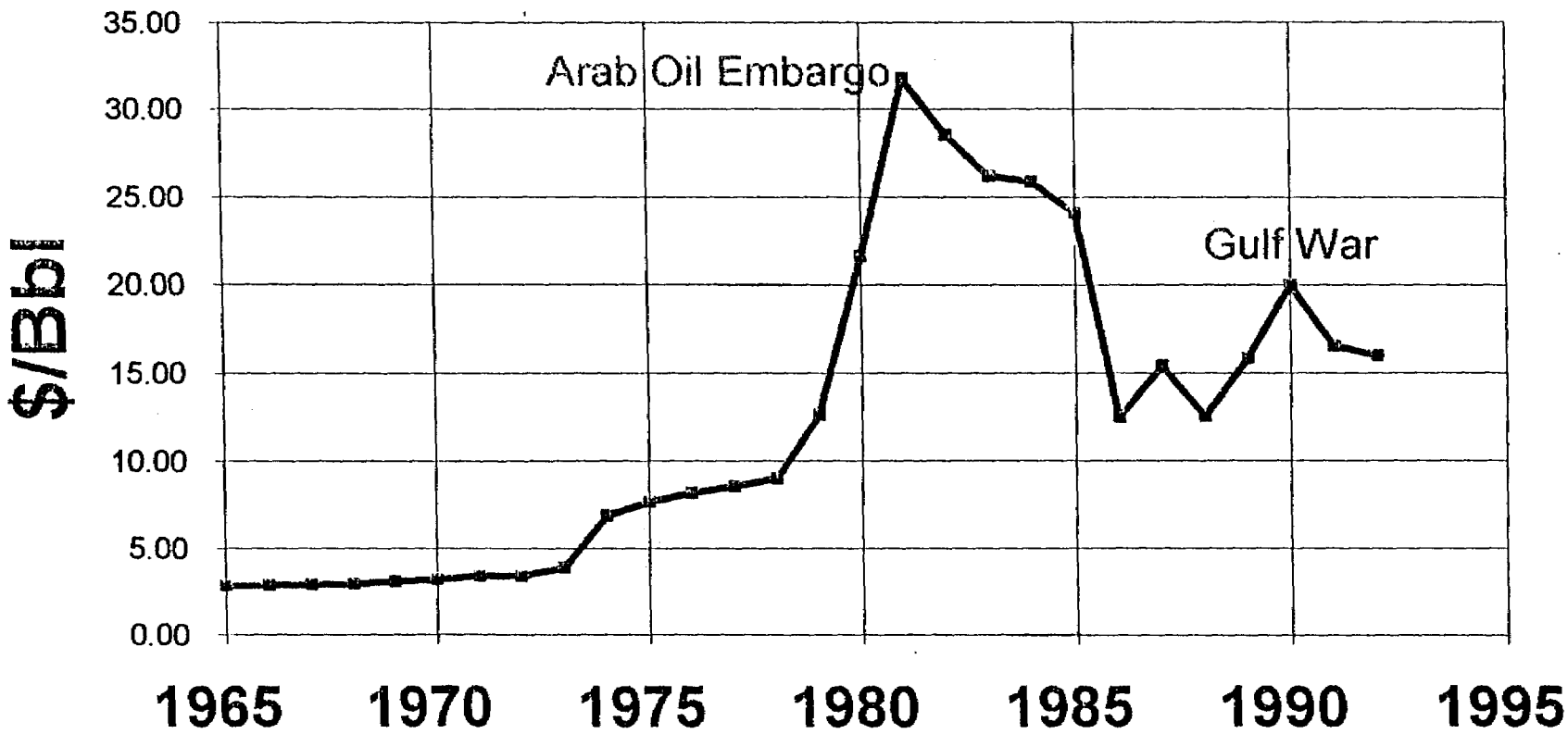
Average Price of U.S. Crude Oil



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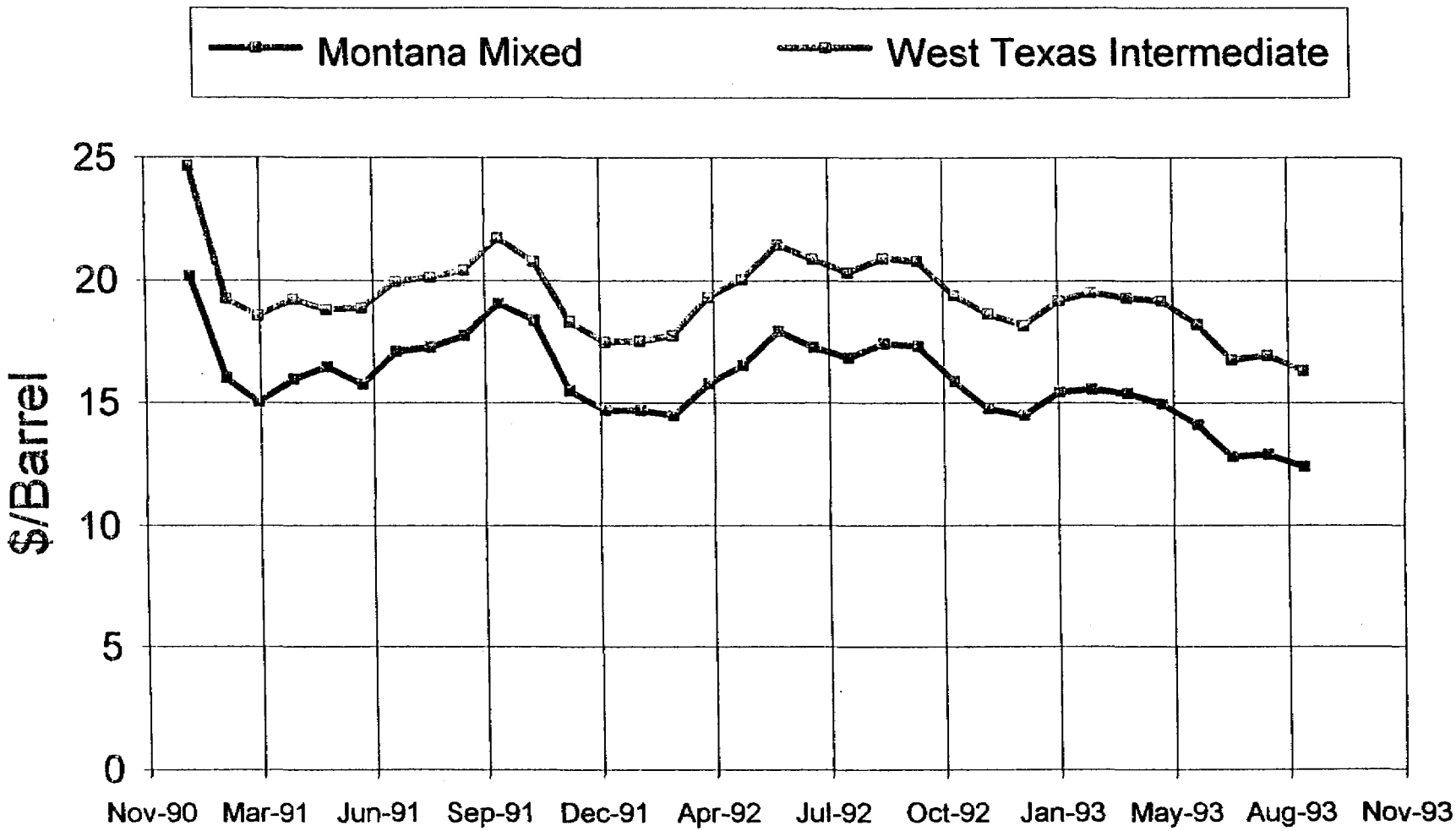
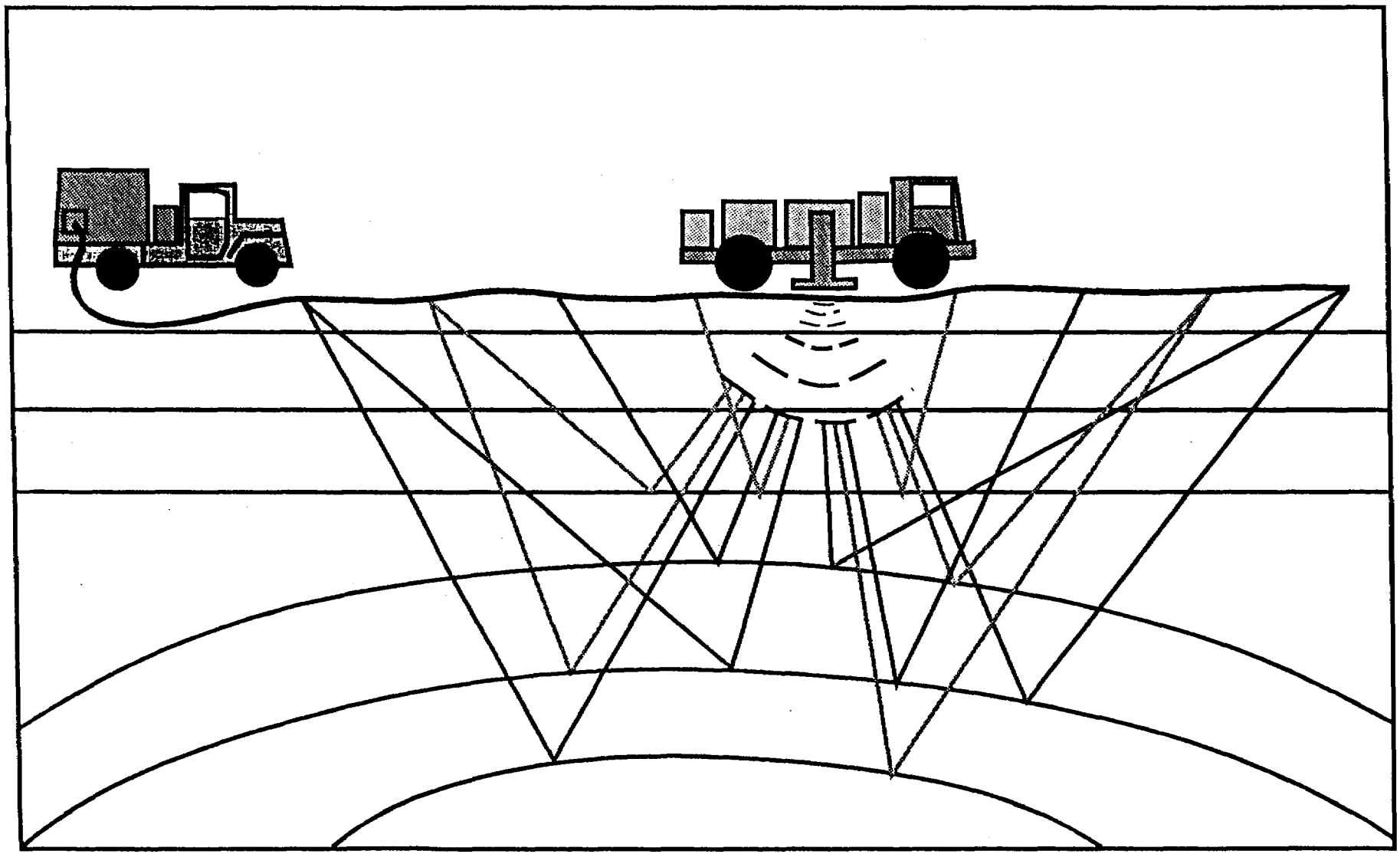
Crude Oil Prices



Seismic



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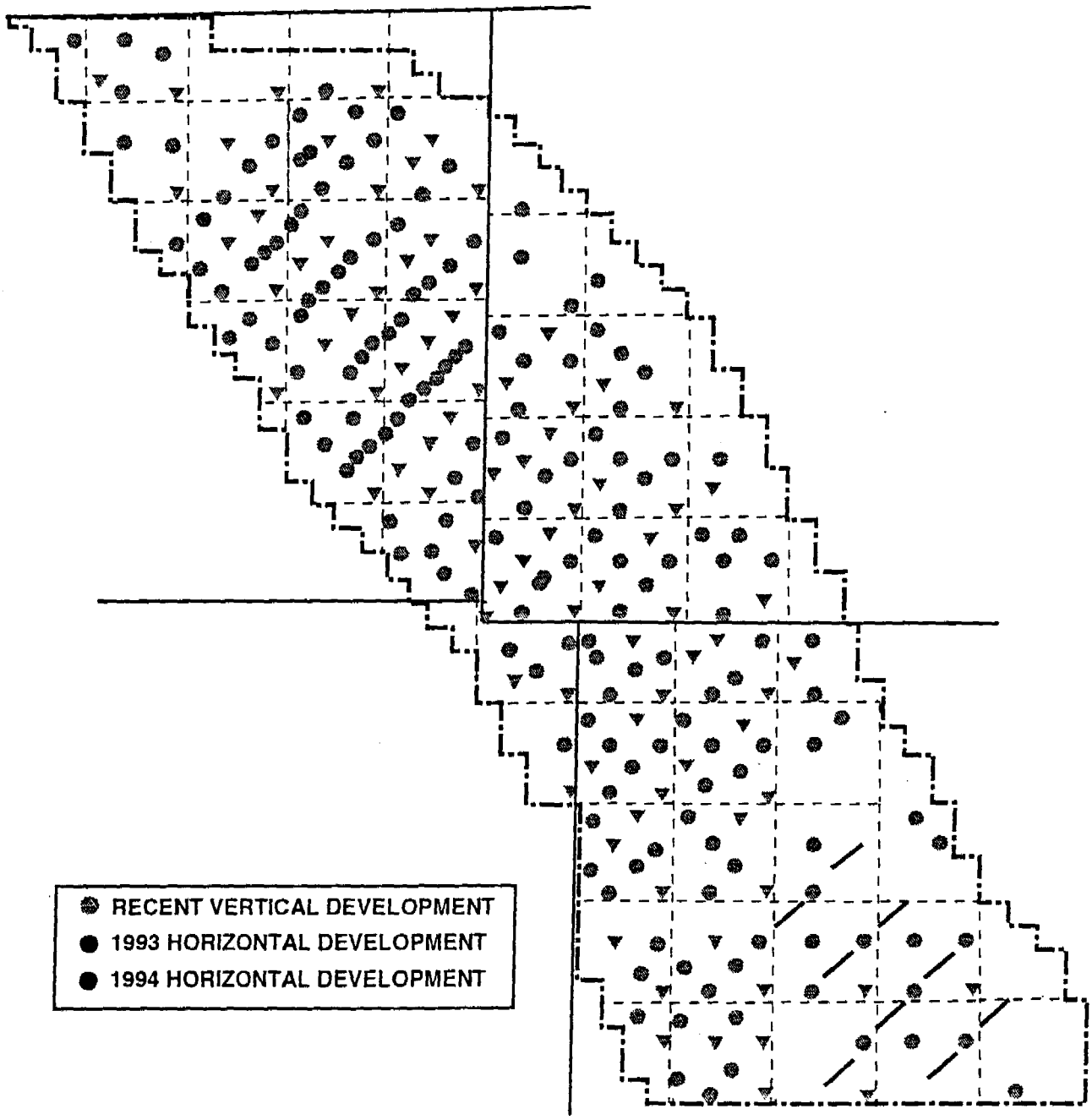
PENNEL WATERFLOOD UNIT

MAJOR DEVELOPMENT PROGRAMS POST 1986



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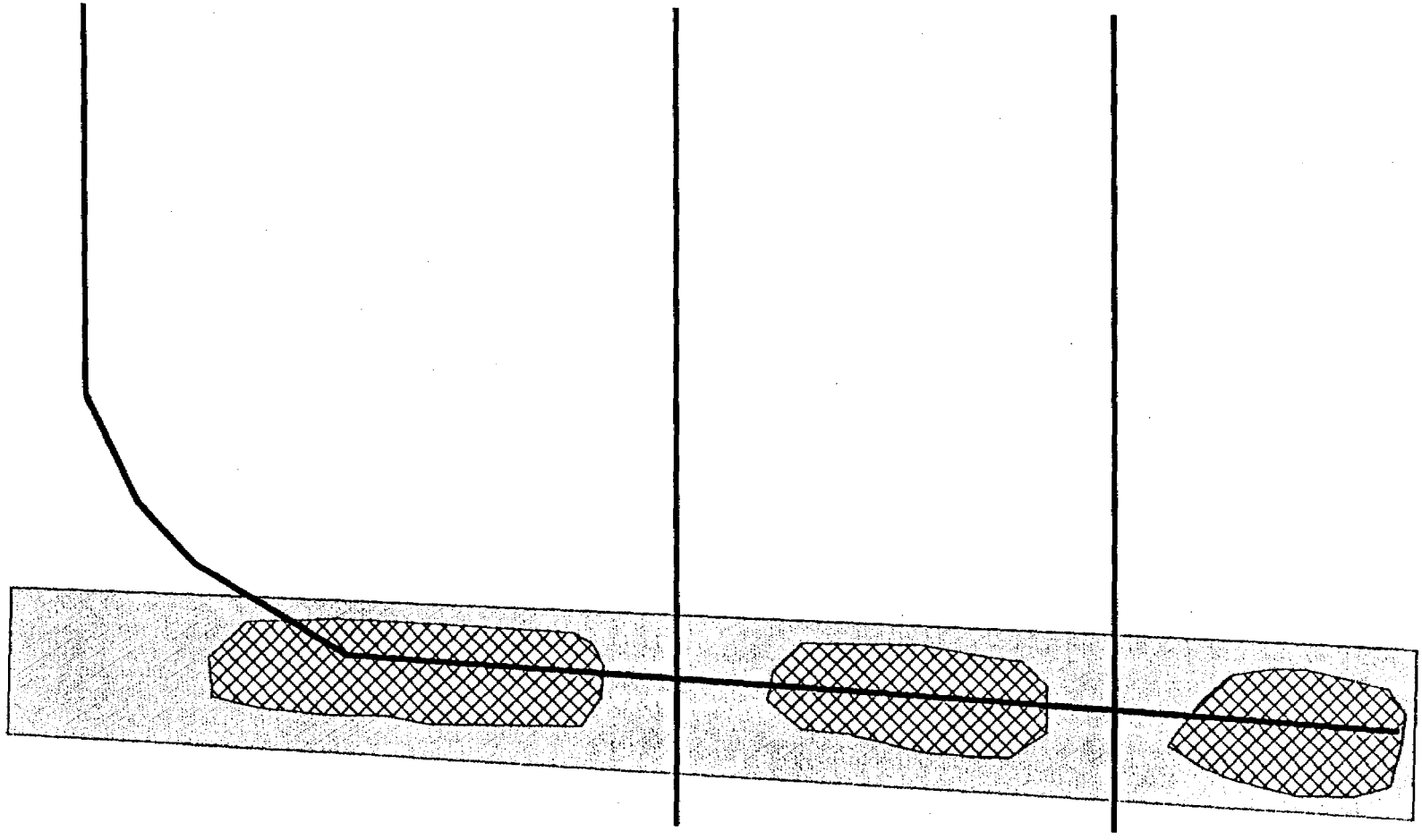
CEDAR CREEK ANTICLINE

HORIZONTAL WELL METHODOLOGY



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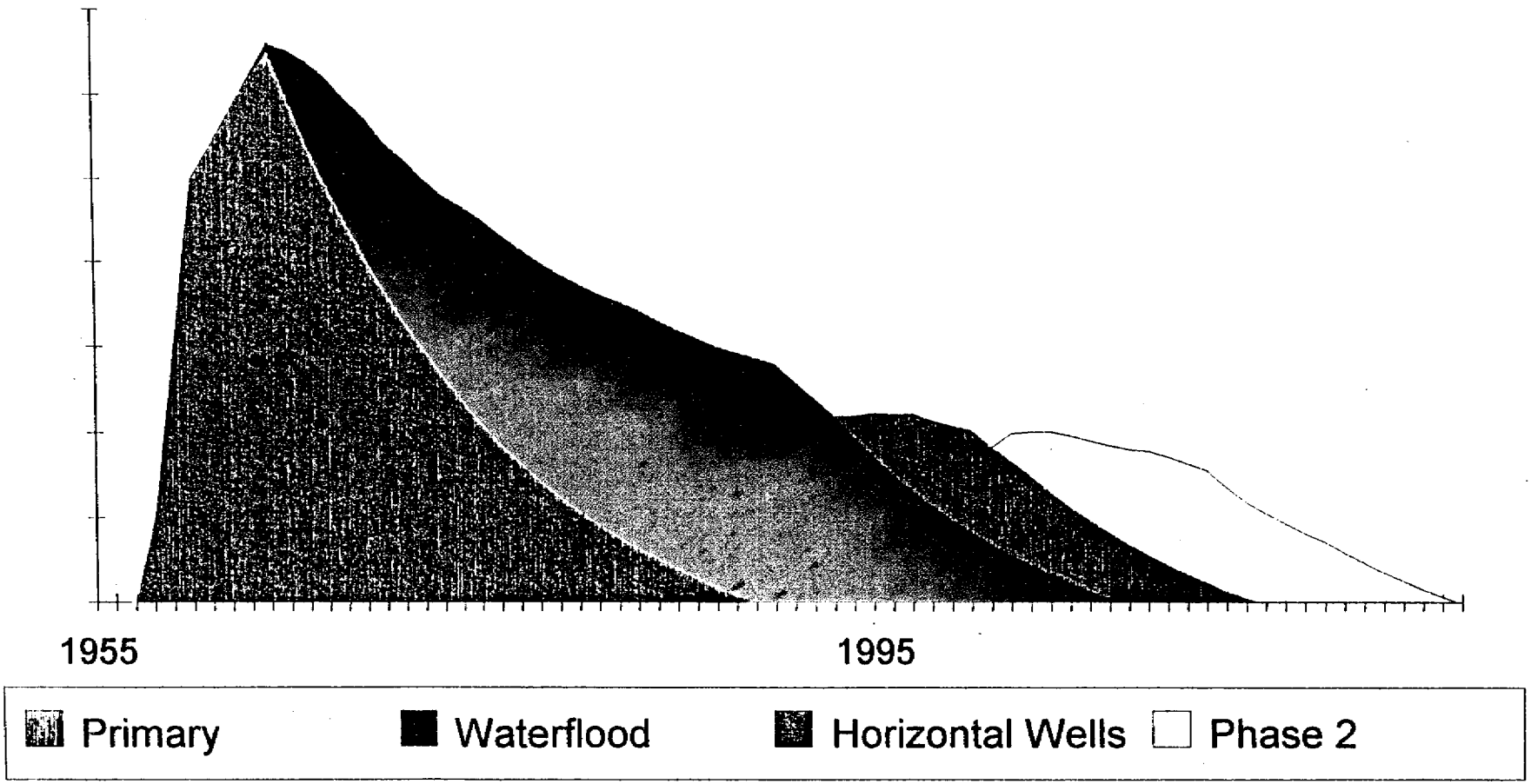
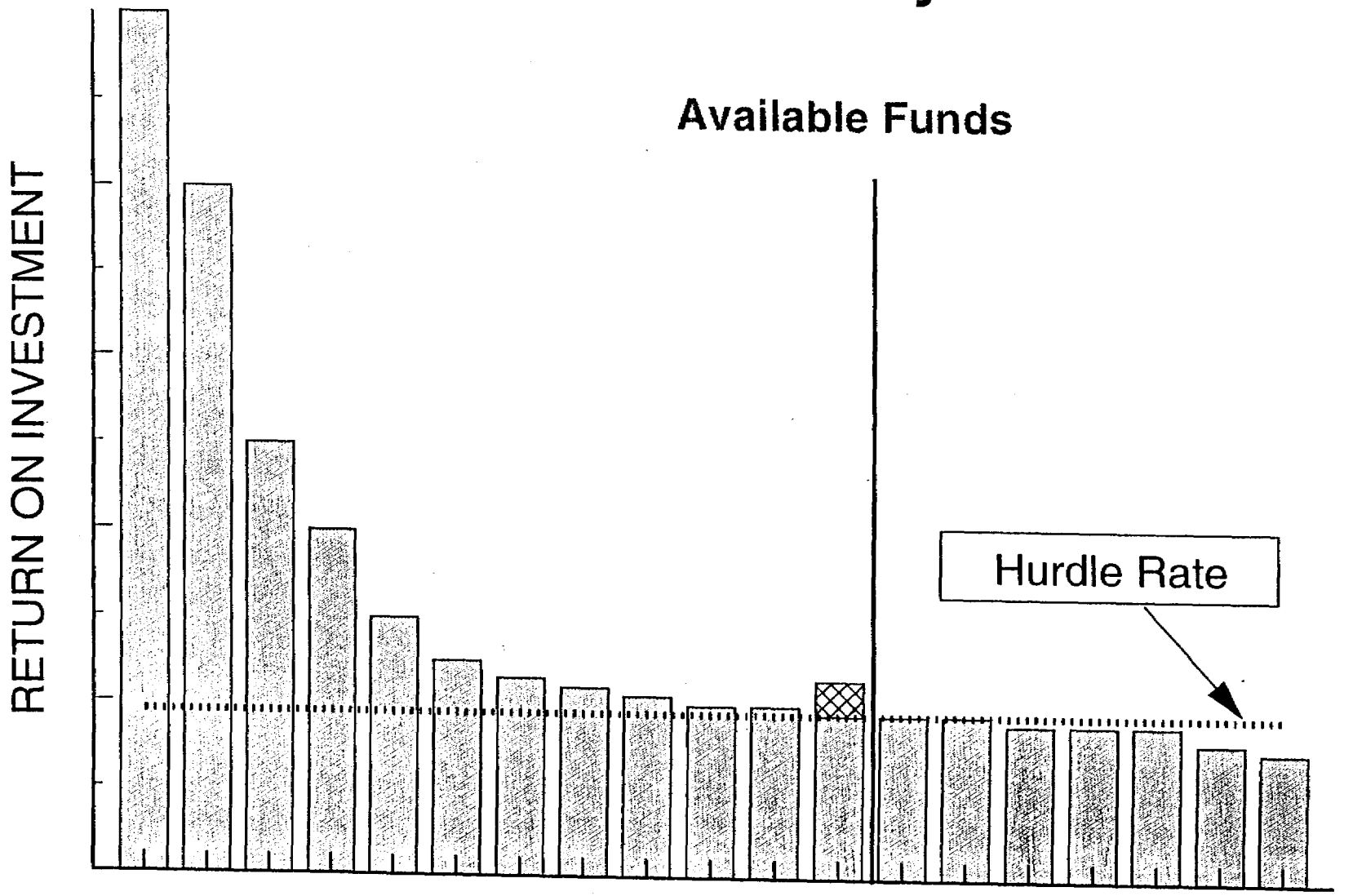
Cedar Creek Anticline
Impact of Horizontal Wells



Project Profitability



LEGISROI.DRW
SSS 11/22/93

C H Kosub
Division Manager
Denver Producing Division
Western E&P Region

Texaco Exploration and Production Inc
8055 E Tufts Ave
Denver CO 80237
P O Box 46510
Denver CO 80201-6510
303 793 4801
FAX 303 793 4975

SENATE TAXATION
EXHIBIT NO. 9
DATE December 2, 1993
BILL NO. SB 18

November 29, 1993

The Honorable Mike Halligan
Chairman
Senate Taxation Committee
Montana State Senate
State Capitol Building
Helena, MT 59620

Dear Chairman Halligan:

Texaco Exploration and Production Inc. (TEPI) has horizontal oil wells in Blaine and Musselshell counties in Montana. We also have secondary recovery operations in Musselshell County. TEPI continues to review options for new horizontal drilling, secondary recovery and other oil and gas activities in Montana.

I strongly urge your support for incentives to encourage horizontal drilling and secondary recovery in your state. These are costly methods that can severely limit project profitability. The State of Montana's heavy tax burden on its oil and gas industry and high costs together put these projects in Montana at a disadvantage when compared to similar projects elsewhere. The proposed incentives would improve the chance that such high cost projects can return a profit in Montana. This, in turn, would improve the prospect of future drilling there.

In closing, TEPI encourages support for these incentives. They offer real benefits for companies that undertake such projects, and for the State of Montana and its people. Thank you for your review of this proposal and our thoughts on it.

Sincerely,

C H Kosub

CHK/kdb

BCC: Gail Abercrombie
Rich Hansen

BALLARD & ASSOCIATES, INC.

December 1, 1993

Chairman Mike Halligan,
Members Senate Taxation Committee

RE: SB18

Dear Chairman Halligan and Members of the Committee:

I am writing to ask your support of SB18. This bill is an incentive to encourage the use of expensive, new technology to develop new oil and gas reserves in Montana. The bill in no way affects tax revenues on existing production, and in fact is a revenue enhancement bill in that it will insure development of new reserves and thus provide a new revenue stream to the State of Montana.

Incentives do work. Evidence of this exists in many other states as well as in Canadian Provinces to the north of our borders. They have worked in Montana, too. In 1987, when the legislature passed some incentive legislation, I pledged to the committee that my company would drill, or cause to be drilled, a minimum of 35 new wells in the State of Montana. In fact, we were responsible for 42 wells during the time that all the incentives existed. SB18 will result in many more than that.

I strongly urge the committee to pass this bill and help provide Montanans with a new source or revenue.

Very truly yours,

W. W. Ballard

W. W. Ballard

WWB:vks

845 12th Street West / PO Box 20174
Billings, Montana 59104
406/259-8790 / FAX 406/259-3884

12-2-93
SB 18

CENEX

TELECOPY TRANSMITTAL
Xerox Telecopier 7012
406-655-6250

DATE: December 1, 1993

TO: Senate Taxation Committee
Capitol Building
Helena, MT 59624
406-443-7291 - MPA - Attn: Gail Abercrombie

RE: SB 18 - Tax Incentives for Incremental Oil

FROM: J. R. Keating
CENEX Exploration & Production
P. O. Box 21479, Billings, MT 59104
406-655-6285

Dear Mr. Chairman:

Today the posted price for Montana crude is $12.15 per barrel. Exploratory test wells within the state are a rarity. Total production from existing wells is declining at a calculated rate shrinking that tax base.

With the Montana oil industry contributing less to the total tax needs of the state, it seems a poor time to suggest adopting SB 18. However, the opposite is true. In the depressed environment of our industry today, it is only additional investments in producing areas that have potential for increased barrels. That portion of our business should be stimulated with incentives.

Please be advised that we support and respectfully urge adoption of SB 18.

Thank you.

Sincerely,

J. R. Keating, Vice President
Exploration & Production

2000 POST OAK BOULEVARD / SUITE 100 / HOUSTON, TEXAS 77056-4400

Apache CORPORATION

(713) 296-6000

December 1, 1993

The Honorable Mike Halligan
Chairman, Senate Taxation Committee
Montana State Senate
State Capitol Building
Capitol Station
Helena, Montana 59620

Dear Chairman Halligan and Members of the Committee:

Please accept this letter as Apache Corporation's strong endorsement of the proposals to provide tax incentives for increasing exploration and production in the State of Montana, especially those incentives dealing with horizontal drilling.

Apache Corporation has developed a significant position in Montana, and we hope to continue to expand. We have 29,000 acres under lease, and are participants in a horizontal well currently being completed. We are in the process of determining whether continued drilling and production make economic sense.

As you know many states have come to the conclusion that increases in exploration and production for oil and gas are necessary to enhance the economy, to preserve jobs, and to protect their state treasuries. North Dakota, Texas, and Wyoming have already adopted incentive programs. Drilling and production incentives will be high on the agendas of the legislatures in Louisiana and Oklahoma. Tax incentives in those states have certainly encouraged more drilling and increased production.

However, the proposal you have before you is unique in that it would encourage one of the most advanced of the high tech operations our industry has developed. This is precisely the kind of activity that states should encourage. Horizontal drilling can produce greater quantities of oil and gas in a shorter time in the most environmentally sensitive fashion because one horizontal well can replace many vertical wells.

More exploration and production means more revenue for the state and more jobs for

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Montanans. Encouraging horizontal drilling is exactly the right thing to do at exactly the right time. And in light of the recent dramatic drop in the world price of crude oil, incentives to spur more domestic exploration and production are even more crucial to the economic health of producing states and to our national security.

Again, Apache Corporation strongly supports the incentives for horizontal drilling that have been proposed. We urge you to move as quickly as possible to enact these incentives and to create more jobs and economic activity in the State of Montana.

Sincerely,

APACHE CORPORATION

Urban F. O'Brien III

Urban F. (Obie) O'Brien, III
Director, Governmental Affairs

UFO:ob/mhc

CHOCTAW CORPORATION

November 30, 1993

Senator Mike Halligan, Chairman
Montana State Senate
State Capitol Building
Capitol Station
Helena, Montana 59620

Dear Senator Halligan:

Choctaw II Oil & Gas, Ltd. is a Texas limited partnership with Choctaw Corporation as its General Partner.

Choctaw currently operates 79 oil & gas wells in the Williston Basin, 45 of which are located in Montana. Additionally, Choctaw holds over 41,000 acres under lease in Montana.

Choctaw feels that horizontal exploration is the future of the basin and has considered commissioning a study for its application in the development of our leasehold acreage. However, as compared with other states where Choctaw operates, Montana costs -- especially taxes -- are excessive.

Therefore, I would encourage you to support legislation being considered during the Special Session to stimulate oil and gas investment in Montana. This is exactly the kind of incentive that would help influence my company's decision to invest more in Montana.

If you would like to know more about my company and our experience in Montana, please call me at (713) 546-8090. Thank you for your support.

Sincerely,

W. Russell Brown, Jr.
Senior Vice President

WRB:bk

700 MILAM, 13TH FLOOR • P.O. BOX 61585 • HOUSTON, TEXAS 77208-1585
(713) 546-8090 • FAX (713) 546-8580

EXHIBIT
12-2-93
SB 18

QUEST PETROLEUM CORPORATION

Corporate Pointe
5250 South Virginia Street, Suite 390
Reno, Nevada 89502
(702) 826-2700

November 29, 1993

Senator Mike Halligan
Chairman, Senate Taxation Committee
Montana State Senate
State Capitol Building
Capitol Station
Helena, MT 59620

Dear Senator Halligan:

Quest Petroleum Corporation is a small independent oil and gas producer operating in Montana and five other western states. In recent years we have drilled three horizontal wells in Montana and are considering drilling additional vertical and horizontal wells and reworking existing wells to improve production. However, as compared with other states where we operate, Montana costs - in particular taxes - are excessive.

Therefore, we would encourage you to support taxation legislation being considered during the Special Session to stimulate oil and gas investment in Montana. This is exactly the kind of incentive that would help influence Quest's decision to invest more in Montana.

If you would like to know more about our company and our experience in Montana, please call me at (702) 826-2700. Thank you for your support.

Very truly yours,

QUEST PETROLEUM CORPORATION

John V.A. Sharp, Ph.D.
President

JVAS:jen

Exhibit 9a

MONTANA PETROLEUM ASSOCIATION
A Division of the
Rocky Mountain Oil and Gas Association

33 S. Last Chance Gulch, Suite 2B
Post Office Box 1186
Helena, Montana 59624-1186

Telephone (406) 442-7582
FAX (406) 443-7291

Gail Abercrombie
Executive Director

STATEMENT IN SUPPORT OF SENATE BILL 18

before the Senate Taxation Committee
December 2, 1993

SENATE TAXATION
EXHIBIT NO. 9A
DATE December 2, 1993
BILL NO. SB 18

David A. Johnson
President
Montana Petroleum Association

My name is Dave Johnson, and I am here as President of the Montana Petroleum Association to speak in support of Senate Bill 18.

This bill encourages the use of enhanced recovery technologies that more fully retrieve the resource from existing fields, and the use of horizontal drilling technologies that also can yield greater recovery from primary production in existing and new fields.

Montana Petroleum Association member Kurt Burris, president of Cardinal Drilling out of Billings, reports that horizontal drilling technologies are changing and improving every month. Over our northern border in Saskatchewan, where there has been more utilization of horizontal drilling, they have been running three to four laterals off of one bore hole. That means one drill pad for an extensive system of resource recovery. Less surface disturbance ... More recovery. Bill White, Deputy Secretary of the U. S. Department of Energy, recently cited a report that concluded that "new technology alone, at every reasonable price scenario, could boost recoverable [crude oil] discoveries by about 45 percent, and the use of advanced technology can have at least as much impact as price increases in terms of increasing resource recovery." The drilling companies of Montana have the equipment for horizontal drilling and enhanced recovery, and are ready to put it to use in Montana.

Our Association members are sensitive to the perception of bringing this incentive bill before you at this time of budget concerns. But we cannot change the realities of lead time these horizontal drilling and enhanced recovery projects need in vying for corporate dollars. This, coupled with the fact that the lower tax rates apply only to the incremental production increases resulting from enhanced recovery, above the naturally occurring production without the enhancement, leads us to support the introduction and passage of this incentive proposal during this special session.

12-2-93
SB 18

As Mr. Bill Ballard, president of Ballard and Associates in Billings, said in his letter to you, "Incentives do work. They have worked in Montana." He pledged to the 1987 legislature to drill 35 new wells in response to the passage of an incentive in that legislative session, and in fact, he was involved in the drilling of 42 wells.

In a letter to the White House, U.S. Senators, including Senator Baucus, wrote "... we need to focus on preserving our domestic oil and gas industry..." and "by encouraging domestic exploration and drilling, we can keep ... dollars and the accompanying jobs, here at home." Senate Bill 18 is part of such a program.

The Montana Petroleum Associations thanks Senator Halligan for his leadership in sponsoring Senate Bill 18, and we urge its passage as Montana's part in the encouragement of domestic drilling while preserving the tax revenues and expanding the taxable production base in Montana.

SENATE TAXATION
EXHIBIT NO. 10
DATE December 2, 1993
BILL NO. SB 18

Sen. Towe to both Mr. Tom Dyk of Meridian Oil and Mr. Robert Sheffield of Shell Western E & P, Inc.

Are you sufficiently convinced that this time it will work even though last time it didn't; that you are prepared to say, okay, if you don't make $140 million in new investment and 138 wells, and I will even spot you 20% off of that, that you will refund the extra tax benefit.

Mr. Sheffield:

I lost you on the last part of the question.

Sen. Towe:

$141 million of new investments is what you both indicated. Lets take 80% of that--what does that amount to?--about $112 million. Lets take $110 million--are you prepared to say that if the two of you combined don't invest the $112 million, that you will refund the extra benefit. Are you sufficiently convinced that you will make that kind of investment; to be willing to commit to that.

Mr. Sheffield:

One more time for help, would somebody help me understand the term refund.

Mr. Dyk:

Let me address the economic point and then also the budget point. ~~We are doing something that is risky still~~. So, no, ~~we are not confident that the whole project will go forward~~. There is technological risks that we are still taking. ~~If the wells don't turn out like we currently project they will, we're not going to go ahead with that project~~. What we are doing with horizontal drilling is something that is new and only 6-years old. We have as much expertise as anybody, but we can't say it's going to work everywhere. If you remember, only 3 out of the 22 different projects that we tried, have gotten past that pilot project. Without that incentive, we may not get over that hurdle. So, I personally couldn't stand up and say, if we don't get the $140 million, I would be willing to refund it. ~~I can't tell you that its going to happen. I can tell you that the prices still have to be there~~. Our long-term look at prices is that they will be at about the $17 or $18 benchmark. If we gain at all, we're just going to gain general inflation. You could see a temporary spike like you did in the Persian Gulf; but we don't control prices, Saudi Arabia and the OPEC nations do. I couldn't tell you that I could give

you that money back because ~~I can't tell you that is going to be, given the economic environment and where we see the technology headed right now,~~ we are willing to start that investment process. The 5-year look is what it could be given that things are as we see them.

Mr. Sheffield:

Now that I understand your point on refund, I would like to emphasize that we don't get any benefit except to the degree that we invest.

Sen. Towe:

Mr. Sheffield, you made the point and commented on it, and very honestly I think, indicating that you don't know for sure that without the incentive, you wouldn't be drilling some wells anyway. I think you said obviously, you would probably drill some. How many dollars of these figures of tax benefits would really happen anyway if we didn't have this incentive.

Mr. Sheffield:

~~That would be pure conjecture~~, I think, on my part. If I could steal some numbers from Tom's company. Let me show you some of the risks involved in horizontal wells. These are wells that Meridian drilled in the (name inaudible) oil field, and as you can see, they had one well that started out producing over 150 barrels a day and then within a year declined to around 70 to 80 barrels. Still doing pretty well, but the other wells that they drilled started out less than 100, and ~~fairly rapid over the course of less than 2 years, declined to less than $30 a barrel.~~ This is a risky proposition. If we do as poorly as that bottom band of wells, this won't go very far because it's just not economic. On the average, we think given that part of the field where we can do a little bit better than that, but there's no cinch bets here unfortunately. We know there is oil there, but we don't know how fast we can get it out.

Mr. Dyk:

I can tell you that right now, what I recommended be done hasn't been approved by the Board of Directors. What we have done this year are marginal. What we have proposed for next year could still not get funded. So I can't tell you that even next years would be done or how much would be done.

STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
STATE CAPITOL, 600 E. BOULEVARD AVE., BISMARCK, NORTH DAKOTA 58505-0599

701-224-2770 FAX 701-224-3700 TDD 701-224-2778

Bob Hanson
COMMISSIONER

November 17, 1993

SENATE TAXATION
EXHIBIT NO. 11
DATE December 2, 1993
BILL NO. SB 18

Representative Jim Elliott
100 Trout Creek Road
Trout Creek, MT 59874

Dear Representative Elliott:

In response to your request for information relating to oil production from horizontal wells drilled in North Dakota, I am enclosing a spreadsheet that details monthly production data from July 1987 through June 1993 for each horizontal well. I have also enclosed a computer disc containing the Lotus spreadsheet file for this data which should allow you to analyze the information with more flexibility.

Just a few comments about the spreadsheet:

a. The first four columns of the spreadsheet show the operator's name, the North Dakota Industrial Commission's well file number, the well's API number (used for tax reporting), and the dates of the 15-month exempt period applicable to the well.

b. The barrels of oil produced from each well are scheduled from the first month of production through June 1993.

c. There are 191 horizontal wells listed of which 189 produced more than 11.6 million barrels since our 15-month new well exemption became effective in April 1987. Approximately 8 million barrels have been exempt from the 6.5% oil extraction tax because of the new well exemption, and 3.6 million barrels were taxed at a reduced rate of 4% after the well's 15-month exempt period expired.

d. Approx. 60% of the wells were low producers, (i.e., 10 barrels or less of average daily production) either initially or by the time the 15-month exempt period expired.

For your reference, I am also attaching a narrative that explains North Dakota's severance tax laws. The portion of the narrative addressing the new well exemption and reduced rate provisions are highlighted.

Please call me at the number below if you need clarification of the enclosed spreadsheet or if you need additional information.

Sincerely,

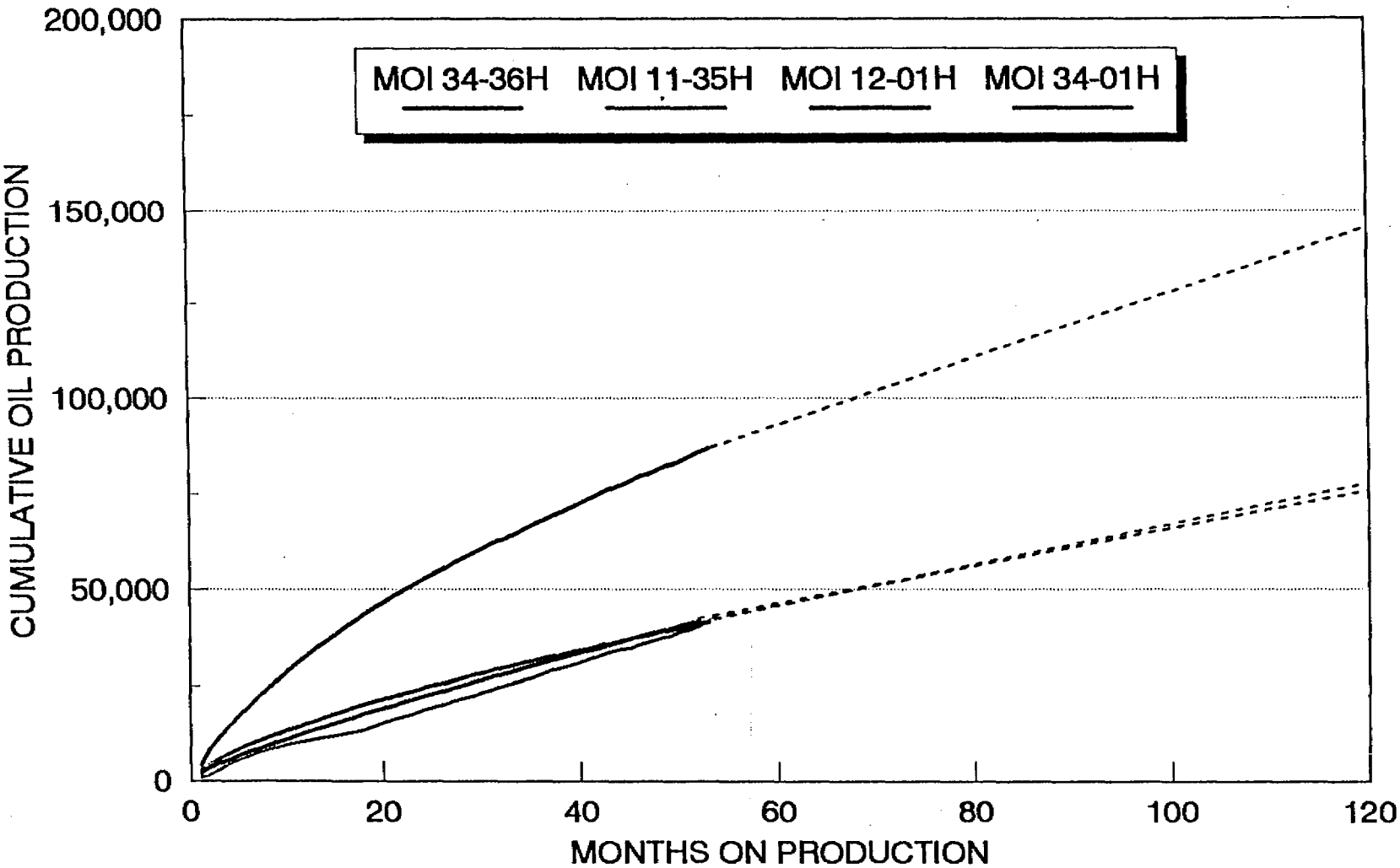
Carole Murschel

Carole Murschel, CPA
Supervisor, Oil & Gas Taxes
Phone: (701) 224-3594

CJM:lkh
Enclosures

SENATE TAXATION
EXHIBIT NO 12
DATE December 2, 1993
BILL NO SB 18

MERIDIAN HORIZONTAL WELL CUMULATIVE PRODUCTION
CEDAR CREEK ANTICLINE



MOICUM.DRW
SSS 11/16/93

HORIZONTAL WELL PRODUCTION VOLUMES

		I.C. FILE#	API#	Exempt Period	9007	9008	9009	9010	9011	9012	9101	9102	9103	9104	9105	9106	FY-91 Total
72	Meridian Oil, Inc.	12092 H	53 - 2178	8/ 28/ 90 - 9/ 25/ 91	2,961	2,558	1,441	1,985	1,258	1,380	1,044	1,037	981	865	979	788	17,317
73	Slawson Expl	12847 H	7 - 1214	8/ 3/ 90 - 9/ 2/ 91	16,478	14,574	11,395	7,881	6,946	11,480	8,955	5,984	6,325	4,693	5,627	771	102,589
74	Conoco, Inc.	12591 H	7 - 1215	8/ 16/ 90 - 9/ 15/ 91	15,428	11,739	10,392	6,858	6,320	9,063	7,418	5,663	5,547	4,882	4,238	3,788	92,156
75	Slawson Expl	12835 H	53 - 2319	8/ 15/ 90 - 9/ 14/ 91	2,970	2,575	2,389	2,296	2,109	2,030	1,924	1,734	1,804	1,675	1,827	1,524	24,957
76	Meridian Oil, Inc.	12870 H	53 - 2321	8/ 10/ 90 - 9/ 8/ 91	3,667	3,490	3,240	3,157	3,791	4,312	4,016	3,587	3,857	3,352	3,578	3,341	43,566
77	Meridian Oil, Inc.	12897 H	53 - 2329	7/ 9/ 90 - 10/ 8/ 91	8,333	9,433	8,327	7,949	7,291	7,170	6,758	6,101	7,114	6,420	6,603	6,134	87,643
78	Pacific Enterpr	12907 H	7 - 1216	7/ 15/ 90 - 10/ 14/ 91	0	0	0	0	0	0	0	0	0	0	0	0	0
79	American Hunter	12593 H	61 - 416	7/ 8/ 90 - 10/ 7/ 91	0	174	141	85	73	44	90	35	0	72	0	50	774
80	Slawson Expl	12920 H	7 - 1218	7/ 15/ 90 - 10/ 14/ 91	11,166	17,326	14,122	13,172	11,330	10,301	8,039	7,552	7,089	6,091	7,167	6,267	120,712
81	Meridian Oil, Inc.	12932 H	7 - 1222	7/ 20/ 90 - 10/ 19/ 91	3,235	7,432	8,345	6,397	5,656	5,892	5,320	4,498	4,704	3,994	4,176	3,666	61,317
82	Conoco, Inc.	12908 H	7 - 1217	7/ 23/ 90 - 10/ 22/ 91	1,184	5,064	5,448	3,288	4,041	3,090	2,841	2,715	2,789	2,858	1,002	1,634	36,732
83	Leede Oil & Gas	12652 H	53 - 2322	7/ 17/ 90 - 10/ 16/ 91	7,110	11,651	9,310	7,534	6,263	4,616	3,535	4,405	3,360	2,564	4,094	3,960	68,622
84	American Hunter	12864 H	105 - 1392	7/ 2/ 90 - 10/ 1/ 91	177	275	104	202	100	104	127	181	0	195	103	0	1,566
85	Union Pacific	12927 H	25 - 456	9/ 1/ 90 - 11/ 30/ 91			369	238	345	225	194	191	170	159	148	98	2,115
86	Pacific Enterpr	12924 H	53 - 2332	9/ 1/ 90 - 11/ 30/ 91			870	858	22	0	158	291	244	0	0	0	2,243
87	Slawson Expl	12934 H	53 - 2334	8/ 18/ 90 - 11/ 17/ 91		877	1,735	1,296	931	804	978	2,093	2,409	1,898	1,789	1,541	16,147
88	Columbia Gas	12815 H	7 - 1200	8/ 14/ 90 - 11/ 13/ 91		8,341	14,593	13,456	9,654	8,195	7,541	5,928	5,903	5,162	4,906	3,845	87,724
89	Meridian Oil, Inc.	11967 H	53 - 2154	8/ 22/ 90 - 11/ 21/ 91		2,169	5,049	3,433	2,518	2,178	1,668	1,384	1,600	1,158	1,261	1,058	23,702
90	Meridian Oil, Inc.	12665 H	7 - 1206	8/ 16/ 90 - 11/ 15/ 91		6,120	6,110	5,506	2,376	6,341	5,222	5,011	4,667	5,024	4,569	3,898	56,644
91	Meridian Oil, Inc.	12966 H	53 - 2337	9/ 28/ 90 - 12/ 27/ 91			1,149	9,441	7,713	7,139	6,658	5,888	2,020	4,882	5,839	5,258	55,889
92	Slawson Expl	12938 H	7 - 1223	9/ 3/ 90 - 12/ 2/ 91			2,032	1,558	1,501	1,278	1,041	1,482	624	1,060	1,096	917	12,589
93	Columbia Gas	12938 H	7 - 1225	9/ 24/ 90 - 12/ 23/ 91			1,850	3,972	3,419	2,306	2,541	1,811	1,507	1,407	1,196	1,462	21,293
94	Conoco, Inc.	12939 H	7 - 1226	9/ 30/ 90 - 12/ 29/ 91			107	3,341	2,561	2,151	1,910	1,500	1,338	1,304	1,115	1,133	16,861
95	Meridian Oil, Inc.	12948 H	7 - 1228	9/ 18/ 90 - 12/ 17/ 91			1,265	4,517	4,040	2,243	2,552	2,258	2,470	2,200	1,310	665	23,520
96	Slawson Expl	12974 H	7 - 1234	10/ 30/ 90 - 1/ 29/ 92				265	1,298	837	758	592	592	548	427	304	5,589
97	Meridian Oil, Inc.	12992 H	53 - 2343	10/ 30/ 90 - 1/ 29/ 92				271	4,595	4,167	3,946	3,372	3,905	3,010	3,415	2,904	29,255
98	Union Pacific	12991 H	25 - 461	10/ 31/ 90 - 1/ 30/ 92				0	0	0	0	0	0	0	0	0	0
99	Meridian Oil, Inc.	12975 H	7 - 1235	10/ 21/ 90 - 1/ 20/ 92				1,135	2,952	2,481	1,962	1,470	1,467	1,635	1,788	1,617	16,727
100	Conoc	12806 H	53 - 2313	11/ 5/ 90 - 2/ 5/ 92					4,175	4,097	3,461	2,806	2,841	2,425	1,332	2,167	23,329
101	Slawson Expl	12925 H	7 - 1221	11/ 16/ 90 - 2/ 15/ 92					1,576	1,862	890	855	1,833	1,853	1,813	1,399	11,301
102	Columbia Gas	12937 H	7 - 1224	11/ 11/ 90 - 2/ 10/ 92					5,880	10,067	8,001	7,037	7,325	5,640	5,438	4,371	54,780
103	Shell Western E&P	12866 H	7 - 1213	11/ 8/ 90 - 2/ 7/ 92					12,145	11,774	9,993	8,535	8,749	6,364	6,151	7,851	75,562
104	Meridian Oil, Inc.	12981 H	53 - 2339	11/ 30/ 90 - 2/ 28/ 92					0	633	1,858	1,474	1,451	1,302	1,122	1,140	8,980
105	Conoco, Inc.	12958 H	7 - 1230	11/ 17/ 90 - 2/ 16/ 92					1,843	1,673	1,317	1,249	1,543	1,231	1,307	1,165	11,139
106	Meridian Oil, Inc.	12998 H	53 - 2344	12/ 10/ 90 - 3/ 9/ 92						0	0	0	0	3,712	4,196	3,556	11,464
107	Meridian	6662 H	53 - 809	12/ 22/ 90 - 3/ 21/ 92						238	8,315	5,853	4,704	5,938	5,060	4,286	35,192
108	Meridian Oil, Inc.	12874 H	7 - 1211	12/ 29/ 90 - 3/ 28/ 92						0	0	0	0	16,685	11,699	12,733	41,317
109	Conoco, Inc.	13024 H	7 - 1237	1/ 31/ 91 - 4/ 30/ 92							0	0	0	5,805	6,214	6,550	18,569
110	Meridian Oil, Inc.	13040 H	53 - 2347	1/ 9/ 91 - 4/ 8/ 92							0	0	0	5,685	5,322	636	11,643
111	Edtex	12966 H	25 - 459	1/ 7/ 91 - 4/ 6/ 92							0	0	0	254	211	120	585
112	Meridian Oil, Inc.	13070 H	53 - 2352	2/ 1/ 91 - 4/ 30/ 92								0	0	2,066	1,817	1,413	5,296
113	Columbia Gas	13004 H	7 - 1236	1/ 20/ 91 - 4/ 19/ 92							0	0	0	6,412	4,639	5,101	16,152
114	Slawson Expl	13027 H	7 - 1238	1/ 6/ 91 - 4/ 5/ 92							0	0	0	6,069	5,768	5,182	19,019
115	Conoco, Inc.	12984 H	53 - 2341	1/ 16/ 91 - 4/ 15/ 92							284	82	0	0	0	0	366
116	Meridian Oil, Inc.	13080 H	53 - 2351	1/ 15/ 91 - 4/ 14/ 92							0	0	0	11,105	10,660	9,679	31,444
117	Meridian Oil, Inc.	13091 H	53 - 2355	2/ 21/ 91 - 5/ 20/ 92								0	0	279	5	132	419
118	Slawson Expl	6567 H	25 - 129	2/ 3/ 91 - 5/ 2/ 92								175	245	193	130	187	930
119	American Hunter	13092 H	53 - 2356	2/ 22/ 91 - 5/ 21/ 92								0	0	50	125	82	257
120	Meridian Oil, Inc.	13003 H	53 - 2345	2/ 3/ 91 - 5/ 2/ 92								0	0	2,931	2,800	2,432	8,163
121	Columbia Gas	12967 H	7 - 1233	2/ 9/ 91 - 5/ 8/ 92								0	0	4,837	2,748	2,042	9,625
122	Conoco, Inc.	13112 H	7 - 1245	3/ 29/ 91 - 6/ 28/ 92									0	9,387	9,004	8,425	26,796
123	Slawson Expl	12964 H	7 - 1232	3/ 9/ 91 - 6/ 8/ 92									0	14,661	12,620	9,982	37,263
124	Meridian Oil, Inc.	13108 H	7 - 1242	3/ 31/ 91 - 6/ 30/ 92									0	4,613	3,664	3,148	11,643
125	Slawson Expl	13108 H	7 - 1243	3/ 17/ 91 - 6/ 16/ 92									0	11,596	8,802	9,690	30,088
126	Meridian Oil, Inc.	13044 H	53 - 2348	3/ 29/ 91 - 6/ 28/ 92									0	742	812	821	1,975
127	Meridian Oil, Inc.	13105 H	53 - 2358	3/ 4/ 91 - 6/ 3/ 92									0	1,456	921	975	3,352
128	Conoc	13124 H	7 - 1248	4/ 15/ 91 - 7/ 14/ 92										412	4,448	3,090	7,950
129	Columbia Gas	13038 H	7 - 1238	4/ 5/ 91 - 7/ 4/ 92										6,924	5,295	3,684	15,903
130	Meridian Oil, Inc.	13120 H	7 - 1246	4/ 5/ 91 - 7/ 7/ 92										16,804	16,437	12,835	46,076
131	Conoco, Inc.	13104 H	7 - 1241	4/ 30/ 91 - 7/ 29/ 92										105	2,569	3,255	6,249
132	Conoco, Inc.	13107 H	25 - 467	5/ 15/ 91 - 8/ 14/ 92											330	0	330
133	Columbia Gas	12952 H	7 - 1229	5/ 28/ 91 - 8/ 27/ 92											1,020	3,843	4,863
134	Conoc	13123 H	7 - 1247	6/ 1/ 91 - 8/ 31/ 92												1,013	1,013
135	Meridian Oil, Inc.	13071 H	53 - 2353	5/ 14/ 91 - 8/ 13/ 92											11,736	15,399	27,135
136	Meridian Oil, Inc.	13178 H	53 - 2363	6/ 17/ 91 - 9/ 16/ 92												4,642	4,642
137	Slawson Expl	13184 H	7 - 1255	6/ 7/ 91 - 9/ 6/ 92												10,884	10,884
138	Conoco, Inc.	13168 H	7 - 1257	6/ 21/ 91 - 9/ 20/ 92												2,201	2,201
139	Meridian Oil, Inc.	13187 H	7 - 1260	7/ 15/ 91 - 10/ 14/ 92													0
140	Columbia Gas	13133 H	7 - 1250	7/ 29/ 91 - 10/ 28/ 92													0
141	Conoc	13194 H	7 - 1262	7/ 17/ 91 - 10/ 16/ 92													0
142	Meridian Oil, Inc.	13185 H	53 - 2362	7/ 19/ 91 - 10/ 18/ 92													0

STATE TAXATION
EXHIBIT NO. 13
DATE December 2, 1993
SB 18

SENATE TAXATION
EXHIBIT NO. 14
DATE December 7, 1993
BILL NO. SB18

COMBINED
MERIDIAN OIL INC. and
SHELL WESTERN E & P

MONTANA
PROPOSED CAPITAL DEVELOPMENT
AND
PROJECTED WELL COMPLETIONS

YEAR	INVESTMENT ($ MILLIONS)	80%	# WELLS COMPLETIONS	80%
1994	$ 22.450	17.96	22	17.6
1995	36.150	28.92	35	28
1996	30.750	24.6	31	24.8
1997	28.500	22.8	28	22.4
1998	23.500	18.8	22	17.6
	$ 141.350	113.08	138	110.4

This information was taken from "Proposed Incentives to Attract Capital Investment in Mo for New Drilling and Enhanced Oil Production" (Exhibit #1) presented by Stan Kaleczyc representing Meridian Oil. Revenue Oversight Committee meeting of November 17, 1993.

DATE 2 Dec 93

SENATE COMMITTEE ON Tax 45

BILLS BEING HEARD TODAY: SB 4, SB 18

< ■ > PLEASE PRINT < ■ >

Name	Representing	Bill No.	Check One: Support	Oppose
JOHN DELANO	BUR. RES	18	+	
W. H. TULLOCH	MERIDIAN OIL INC	18	✓	
BRENT J. SMOLIK	MERIDIAN OIL INC	18	✓	
Gloria Paladichuk	Richland Co. Commissioner	18	✓	
Bob Sheffield	Shell Oil Company	18	✓	
Perry Pearce	Meridian Oil	18	✓	
Sue M. OLSON	MT Oil, Gas & Coal Ctys	18	–	
Don RIEGER	MT. Ass. of Oil, Gas, Coal Ctys	18	–	
JEROME ANDERSON	SHELL WESTERN E&P INC	18	✓	
Harold M. Robinson	Musselshell County	18	✓	
Rick House	Shell Oil	18	✓	
STAN KAWCZYC	MERIDIAN OIL	18	✓	
W. M. (BILL) VANGHEY	SELF-AN INDEPENDENT PROD.	18	✓	
TOM RICHMOND	BOARD OF OIL & GAS CONSERVATION	18		

VISITOR REGISTER

PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY

DATE Dec 2, 1993

SENATE COMMITTEE ON Tax

BILLS BEING HEARD TODAY: SB 4 SB 18

< ■ > PLEASE PRINT < ■ >

Check One

Name	Representing	Bill No.	Support	Oppose
WALTER L MCNUTT	RICHLAND DEVELOPMENT	18	✓	
Dan Franz	Franz Const. Inc	18	✓	
JOHN PIGG	H.R.P. OIL PROPERTIES	18	✓	
DAVE CRAMER	DAVES HOTOIL STA.	18	✓	
JIM TUTWILER	MT CHAMBER	SB18	✓	
Everett Mitchell	Baker Mt.	18	✓	
Rocky Gorder	Sidney Mt	18	✓	
Robert Marquiss	Sidney MT	18	✓	
Del Kenitzer	Baker Mt.	SB18	✓	
DAVID A. JOHNSON	MT. PETRO ASSOC	SB18	✓	
GAIL Abercrombie	MT Petroleum Assn	SB18	✓	
DENNIS IVERSON	Northern Montana Oil & Gas Assoc.	SB18	✓	
Dawson Bird	MT Taxpayers	SB18	✓	
Arnell Anderson	Dept of Commerce	SB4	—	—

VISITOR REGISTER

PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY

DATE 2 December 1993

SENATE COMMITTEE ON Senate Taxation

BILLS BEING HEARD TODAY: SB 4, SB 18

< ■ > PLEASE PRINT < ■ >

Name	Representing	Bill No.	Check One: Support	Check One: Oppose
Steve Bender	OBPP	4		
Ken Williams	Entech	18	✓	
Tom Ebzery	Exxon	18	✓	
Sen. Smith-Mans	SD 12	18	✓	
Peggy Trenk	WETA	18	✓	

VISITOR REGISTER

PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY

DATE 2 December 1993

SENATE COMMITTEE ON Taxation

BILLS BEING HEARD TODAY: SB 4, SB 18

< ■ > PLEASE PRINT < ■ >

Name	Representing	Bill No.	Check One: Support	Oppose
Rick Hill	GOVERNOR	SB 18	X	
Brian Smith	Revenue	SB 18		
Van Charlton	Revenue	SB 18		

VISITOR REGISTER

PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY

demonstration projects. He noted this provision would address the auditors' concern about the transfer of money within all of the accounts.

Motion:

Senator Towe moved to AMEND SB 4 (Exhibit #4a).

Discussion:

Senator Towe noted that the amendments actually incorporated the amendments from yesterday (Exhibit #4) with the ones that **Jeff Martin** just described. **Jeff Martin** agreed, noting that the repealer of the section had been added which eliminated the authorization letting the money go to the Clean Coal Demonstration Fund.

Senator Towe informed the Committee that these amendments assume that those amendments the Committee adopted yesterday do not apply. He reminded committee members that he had referred to damage control during the hearing on SB 4, and stated **Greg Petesch** was of the opinion that the only way to accomplish the necessary damage control was to go into the 1991 law and repeal that one section which required a transfer. He said DOR had never made that transfer, and the auditor had insisted that transfer made; in order to make it clear that DOR should not make that transfer, it is necessary to repeal the transfer language.

Chair Halligan stated because the Committee had adopted the amendments (Exhibit #4) it may be necessary to strip those amendments before the Committee adopts the amendments currently under discussion (Exhibit #4a).

Senator Towe withdrew his MOTION TO AMEND SB 4.

Motion/Vote:

Senator Towe moved to STRIP YESTERDAY'S AMENDMENTS (Exhibit #4) AND TO AMEND SB 4 (Exhibit #4a). The MOTION CARRIED UNANIMOUSLY.

Motion/Vote:

Senator Towe moved SB 4 DO PASS AS AMENDED. The MOTION CARRIED UNANIMOUSLY.

EXECUTIVE ACTION ON SENATE BILL 18

Discussion:

Chair Halligan informed the Committee that several sets of amendments to SB 18 had been drafted and then distributed a set [illegible] (Exhibit #5). He explained that the amendments

responded to four of the concerns committee members had raised during the hearing on SB 18. First, the amendments would correct an oversight and remove all references to natural gas remaining in the body of SB 18. **Chair Halligan** said the reference to natural gas had been omitted from the title, but not the body of SB 18, and added that the inclusion of natural gas had never been intended. Second, the amendments would clarify that the incentive applies only to enhanced recovery, that incremental portion above existing flows. **Chair Halligan** noted the new language addressed **Senator Towe's** concern that the current language in SB 18 did not specify that intent clearly enough. Third, the amendments would establish the duties of the Board of Oil and Gas Conservation (BOGC) and DOR as they apply to the determination and the taxation of the incremental production levels. **Chair Halligan** noted **Senator Doherty** had been concerned that SB 18 would grant BOGC authority to tax. He explained the amendments would specify that BOGC would certify the decline rates to DOR which would use those rates to establish incremental production levels and to determine and to levy the actual tax. Fourth, the amendments would direct BOGC to make at least a yearly report on the implementation of SB 18 to the Revenue Oversight Committee. **Chair Halligan** stated this amendment would provide the Legislature with regular empirical information by which to evaluate the consequences and usefulness of SB 18. He said this amendment addressed the problems **Senator Yellowtail** had voiced about industry accountability.

Senator Towe asked for further clarification. In response, **Jeff Martin** identified the language and effect of each specific amendment (Exhibit #5) as it applied to the general description given by **Chair Halligan.**

Referring to amendments nine and ten, **Senator Towe** asked **Jeff Martin** to clarify the difference between "approval" and "certify". **Jeff Martin** responded he understand the concepts to be related; BOGC would approve the production decline rate of a project and then certify that approval to DOR.

Chair Halligan turned the meeting over to **Vice-Chair Eck** for the purposes of executive action on the amendments he was proposing for SB 18.

Motion/Vote:

Senator Halligan MOVED TO AMEND SB 18 (Exhibit #5). The MOTION CARRIED UNANIMOUSLY.

Discussion:

Senator Halligan said **Vice-Chair Eck** had expressed the concern that BOGC might not have sufficient staff to handle the application process. He stated SB 18 should be amended to

address that concern and asked **Tom Richmond, BOGC,** if BOGC currently had rule-making authority to establish fees. **Mr. Richmond** replied BOGC had some authority related to very specific fees, but added that statute did not grant BOGC authority to establish a fee for the administrative duties it would receive if SB 18 were adopted.

Since BOGC would have increased staff time directly related to the passage of SB 18, **Senator Halligan** stated it was important to grant BOGC the ability to establish a fee schedule BOGC's associated with the application process of horizontal, tertiary and secondary enhanced recovery projects. He asked **Tom Richmond** to comment on what sort of authority would be appropriate. **Mr. Richmond** suggested that the Committee establish BOGC's authority to assess the fee, but, aside from a possible cap, not set the fee in statute. He explained that allowing BOGC to determine the fee administratively would be the best solution because the complexity and the necessary staff time to process applications would greatly vary and would need to be addressed on a case by case basis. He noted BOGC could probably adopt rules recognizing a fee schedule based on some kind of a sliding scale. **Senator Halligan** asked if the Committee should grant BOGC rule-making authority directly related to SB 18 or a general rule-making authority, since its rule-making authority for other fees was ambiguous. **Mr. Richmond** noted a general rule-making authority would "certainly be a gift [he] would be happy to take home with [him]".

Vice-Chair Eck asked if general rule-making authority could be added to SB 18. **Senator Halligan** replied he thought the Committee could amend SB 18 to establish rule-making authority to implement the act. **Senator Towe** noted that SB 18 already contained rule-making authority and that expanding that authority would be germane to the title. He said the question was whether the Committee wanted to expand that authority, and added if the Committee decided to do so a reference should be included both in the title and in the statement of intent as well as in the body of SB 18.

Motion:

Senator Halligan MOVED to AMEND SB 18 WITH AN AMENDMENT TO BE DRAFTED THAT WOULD GIVE BOGC FURTHER RULE-MAKING AUTHORITY TO DEVELOP A SLIDING SCALE FEE SYSTEM BASED ON THE COMPLEXITY OF THE APPLICATIONS.

Discussion:

Senator Halligan commented he was unsure whether the Committee should place a cap on that fee schedule.

Senator Towe asked to whom the fee would be assessed. **Mr. Richmond** said he would anticipate that the company applying for an increment determination would pay the fee.

Senator Towe said he felt uncomfortable approving such an amendment when the Committee did not know what the fee would be, how it would work, or how the amendment would be drafted.

Senator Halligan stated the Committee would not know the amount of the fee, and asked how much a comparable fee currently amounted to. **Mr. Richmond** said BOGC currently administers a drilling permit fee which varies by depth; the price range for that permit was set in 1953 and was $25 for shallow wells, $75 for medium depth, and $150 for deep wells. He stated that the fee BOGC staff had been unofficially discussing was "somewhere in the neighborhood of $500 for a complex application and going down from that for the lesser complex applications".

Vice-Chair Eck asked if BOGC could use $500 as a cap. **Mr. Richmond** agreed that a $500 cap was a possibility.

Senator Towe asked **Mr. Richmond** how he envisioned determining the appropriate fee and what language the Committee should adopt in order to give BOGC the necessary authority. **Mr. Richmond** replied he thought the best rule-making approach would be to estimate the amount of staff time required to process an application, place a dollar value on each hour of staff time, and then keep track of how much staff time is actually used, honoring the cap. He stated it would be fair to let the applicant know the estimated costs prior to the actual work.

Senator Towe asked if BOGC would charge the fee after the work was completed. **Mr. Richmond** replied most of the applications would be done by public hearing, and said the fee should be paid at the time the application is noted for public hearing.

Senator Towe commented the fee would then have to be based on an estimate. **Mr. Richmond** agreed, but added it would be understood that those were estimated costs and there would be a final number and any difference could be recompensed either to BOGC or the applicant.

Jeff Martin said the statute on BOGC's privilege and license tax contained language referring to fees established "for the purposes of providing funds for defraying expenses for BOGC" and "rule-making authority pursuant to a map of fixed assessment". He noted the Committee could adopt similar language which would set an upper limit and refer specifically to the fees for an application.

Senator Towe proposed that the Committee pull that statute into the code and add a new section which would provide that BOGC shall have the authority to establish a fee for determining the incremental production for each application based on the staff time necessary to process the application not to exceed $1000. He noted $500 was not high enough to allow BOGC to recoup its costs.

Motion:

Senator Towe MOVED TO AMEND SB 18 CREATING A NEW SECTION PROVIDING THAT BOGC SHALL HAVE THE AUTHORITY TO ESTABLISH A FEE FOR DETERMINING THE INCREMENTAL PRODUCTION FOR EACH APPLICATION BASED ON THE STAFF TIME NECESSARY TO PROCESS THE APPLICATION NOT TO EXCEED $1000, AND ALSO APPROPRIATELY AMENDING THE TITLE AND STATEMENT OF INTENT. **Senator Towe** explained that reference needed to be made in the title and statement of intent because the amendment would grant rule-making authority.

Discussion:

Senator Halligan asked **Mr. Richmond** how much staff time would a complex application take, he asked if $500 was enough or too much. **Mr. Richmond** explained that the staff time necessary would include a mix of professional, clerical and computer time, and added that $500 would cover at least 20-25 hours.

Senator Van Valkenburg asked how the Committee could determine an appropriate cap. He suggested that the Committee simply adopt language which provided that BOGC should recover the costs of processing the application.

Motion/Vote:

Senator Towe amended his motion to cut reference to a cap. The MOTION TO AMEND SB 18 GRANTING BOGC RULE-MAKING AUTHORITY TO ESTABLISH A FEE SCHEDULE TO DEFRAY THE EXPENSES FOR REVIEWING PROPOSED ENHANCED RECOVERY PROJECTS. The MOTION CARRIED UNANIMOUSLY.

Discussion:

Senator Towe distributed a set of amendments to SB 18 (Exhibit #6). He stated the purpose of the amendments was to build yearly goals into SB 18 using 80 percent of the oil industry's own projected number of wells per year as a benchmark. He explained the amendments would cause the entire act and the incremental tax breaks to terminate for the following years if those goals were not met by January 1 of the corresponding year. In order to accomplish this, **Senator Towe** said BOGC would be required to certify the total number of wells completed in that year to the Governor and be given the authority to accumulate and disseminate information on anticipated numbers of wells. He noted this provision would allay companies' fears of violating anti-trust laws and make it easier to reach the necessary number of wells drilled.

Senator Towe stated the testimony yesterday made it clear that the best way to evaluate the success of SB 18 was to identify the number of new wells drilled and not jobs created or capital investment.

Motion:

Senator Towe MOVED TO AMEND SB 18 (Exhibit #6).

Discussion:

Senator Grosfield noted that **Senator Towe's** amendment would terminate sections one and six, which would affect only the 18 month holiday and not the incremental production after the 18 months.

Senator Towe asked **Jeff Martin** if the reduced rate after the 18 months would also be terminated. **Jeff Martin** replied the lower rate would continue.

Senator Grosfield commented that nothing would be gained by the amendment. He stated that **Senator Towe** was attempting to "put a monkey on the industry's back" in order to ensure that the oil companies take advantage of the incentives contained in SB 18. He said if the companies do not drill quite enough wells in one year and then drill no wells in the subsequent years because they cannot be economically justified, Montana would have lost the whole deal. He stated he was uncomfortable with the amendment.

Senator Towe responded he was uncomfortable with SB 18. He added he was not certain that the incentives were necessary to get the wells under discussion. He said the oil companies could certainly show the Committee "all kinds of great graphs" that indicated that Montana projects were right on the margin of profitability and would not be economically justifiable if oil prices dropped $.10 or if the tax was not decreased by $.10, but stated he remained unconvinced. He noted the companies had done a great sales job in eastern Montana and added he wanted to be sure that they actually performed like they have told everybody they would. He stated if they did not perform, they were not entitled to the tax break. He commented if the companies show a good faith effort, the next Legislature will no doubt grant some relief, and said his amendment presented "a good way to hold their feet to the fire".

Senator Halligan responded that the companies are only trying to sell a plan. He added that the record reflected the industry's projected number of wells and the Revenue Oversight Committee would be meeting, receiving and reviewing BOGC's report, and asking the industry to explain any shortfalls. He stated if the industry did not appear to be complying with their testimony before the Committee, he expected legislation to address the situation or eliminate the incentive to be introduced in the next session. **Senator Halligan** stated SB 18 embodied a serious attempt to establish some benchmarks, but a statutory benchmark would penalize the rest of the industry if one big company did not meet its obligation. He noted that lots of independents would be taking advantage of the incentives in SB 18, not just Shell and Meridian, and added it would be possible to determine which

company was not being accountable because the actual permits would be available for legislative perusal.

Senator Towe replied it was not realistic to think that this Committee or this Legislature would repeal SB 18 at that point. He stated the legislative process in Montana "does not work that way". He added "if we don't do it now, we will never get it done".

Senator Eck commented that if the dates in the amendment were changed from December 31 to July 1 of the following year, it would make the option of legislative review more realistic, since the Legislature would be back in session. She said if it looked like the industry was making some good efforts, the Legislature could address the potential termination of the incentives. She noted that she would personally be satisfied if six new wells were drilled by July 1, 1995. **Senator Towe** agreed and verified that **Senator Eck's** suggestion was to change each one of the dates in his amendment to six months later.

Motion:

Senator Towe amended his motion to amend SB 18 by changing all dates in his amendment to six months later.

Discussion:

Senator Yellowtail objected to that concession. He urged **Senator Towe** to remember that the benchmarks proposed in the original motion were only 80 percent of the companies' projections, and to remember that the Montana Legislature was loathe to rescind a tax gift. He stated it was unrealistic to expect that ever to happen. He stated the industry could easily concoct alibis for why they were not delivering on their promises. He noted the industry confirmed yesterday that Montana tax policy was only in the shadow of the world oil market as it effects their ability to deliver on these projects. According to **Senator Yellowtail**, that argument comprised an automatic alibi. He stated **Senator Towe** was right to set some modest targets which are only a percentage of their own projections into statute and make the industry comply. He stated "do not subject this process to the political whims of this Legislature further".

Senator Halligan asked that someone from the industry respond to the proposed amendments (Exhibit #6). **Stan Kalezyck, Attorney representing Meridian Oil,** responded the practical effect of **Senator Towe's** amendment would be that Meridian would have to evaluate the project as though the tax incentives did not exist. He explained Meridian planned its drilling program for the entire year and had to make those decisions independently of Shell Oil or any other oil company in the state; as a result, Meridian would have to assume that something is going to go awry and the tax incentives will not be in place. **Mr. Kalezyck** reminded the Committee that Meridian would not receive any benefit from SB 18

unless they invested approximately $1 million per well. He noted if Meridian drills ten effectively dry wells, the state and local revenues would still receive the advantages of $10 million investment. According to **Mr. Kalezyck**, even if those wells portended the end of the program for 1994 in that particular field, Meridian might come back in 1995 and drill in another field in Montana. He said he understood what **Senator Towe** was trying to accomplish, but stated the incentive was already in SB 18.

Senator Yellowtail said if the industry preferred, the Committee could amend SB 18 to name each company and insert the projections they provided to the Committee. He noted that "the whimpering has begun already".

Senator Towe stated he was upset that the oil companies made the rounds and convinced the people in eastern Montana that the companies would invest $141 million in Montana, drill 138 wells, and local and state governments will receive $122 million in new revenue over the next 30 years if the Legislature would grant them these incentives. He stated it seems the people in eastern Montana "have been sold a bill of goods" given the companies' negative response to a measure which would make them accountable to only 80 percent of their own projections.

Senator Gage noted that if the person who put together a drilling program had complete control of that program, he could see the sense in the amendment. He stated, however, that drilling for oil and the completion of wells in Montana involve so many factors that are variable and uncontrollable like the weather or rig availability.

Senator Towe reminded the Committee that he had changed the dates contained in his amendments to six months later. He noted that would not provide any assurances, but would give the Legislature a chance to review the special circumstances before the act terminates. He stated it was a fair provision.

Senator Gage asked if the amendments could be segregated, but **Senator Harp** spoke against segregating the amendments.

Vote:

The MOTION TO AMEND SB 18 FAILED BY ROLL CALL VOTE (Exhibit #6).

Discussion:

Senator Doherty said he had requested an amendment which would have required DOR to retain full authority for adopting the rules necessary for taxes and the incremental rates in consultation with BOGC. He asked **Jeff Martin** to review how **Senator Halligan's** amendments (Exhibit #5) affected SB 18. **Jeff Martin** replied that those amendments statutorily established the consultation between

BOGC and DOR in the determination of the production decline rate which would be used to determine the production increments for tax purposes. He added that DOR would retain its current authority to determine old and new production, which would involve different tax rates whether it the well was net proceeds or LGST.

Senator Doherty said he would not offer that amendment since the combination of **Jeff Martin's** explanation and the letter from **Mick Robinson** submitted to the record (Exhibit #7) gave him a certain degree of comfort, that taxing authority had not been given to an entity which had not had authority before and which, he said, should not have power over taxes.

Senator Doherty distributed another proposed amendment to SB 18 (Exhibit #8). He explained that the amendment would install a trigger price of $30/barrel in SB 18; if the price of oil in a quarter was $30/barrel or more, the tax breaks would fall off for that quarter on the production in that quarter and for that quarter only. He noted that if the price of oil were to drop below that threshold, the oil companies would still receive the tax breaks granted in SB 18. **Senator Doherty** stated if the price of oil was $30/barrel the oil companies would not need the incentive. He explained he had selected $30/barrel because it would put "Montana in the ballpark" since North Dakota has a trigger price of $33/barrel.

Senator Towe asked if the incentives would fall off in each quarter the price is above $30/barrel, or if they would be gone and never come back once they fall off. **Senator Doherty** replied if the price of oil was $30/barrel for the quarter and the incentive drops off for that quarter, the incentive would be reactivated the following quarter if the price dropped below $30/barrel. **Jeff Martin** noted that the amendment read "incremental production from a new enhanced recovery project is subject to the tax rate imposed in [those sections] if the price per barrel of oil is under $30/barrel". He stated that language stipulated that for any quarter oil was under $30/barrel it would be subject to those tax rates, if oil went above $30/barrel for the quarter, it would be taxed at the higher rates.

Senator Towe asked what would happen if the price of oil goes up to $33/barrel and stays around $33/barrel until the last day of the quarter when it dips below $30/barrel. **Jeff Martin** replied the calculation would be based on the average price in the quarter.

Motion:

Senator Doherty MOVED TO AMEND SB 18 (Exhibit #8).

Discussion:

Senator Halligan asked **Tom Hoffman**, to respond. **Mr. Hoffman**

replied that DOR had no problem with the $30/barrel threshold, but asked that the Committee establish a definite and general index by which to gauge the price of oil. He noted if that index was hooked to the price individual companies receive for their oil, keeping track of prices and calculating taxes would really present a problem for DOR.

Senator Grosfield noted the price of $30/barrel was not specific enough. He asked $30/barrel for what kind of oil. **Senator Towe** replied the average price of every kind of oil sold in the state that is taxed.

Jeff Martin noted the amendment's current language provided that the price of oil would be determined by the production from a project or a leaser-unitized area. He said the Committee would need to specify how that price should be calculated if DOR's concerns were to be addressed.

Don Hoffman informed the Committee that the law had previously used the price of west Texas intermediate crude as reported in the *Wall Street Journal* as a benchmark. He noted that west Texas intermediate crude commanded between $1 to $2/barrel more than what most producers in Montana could get for their oil. He added it would, at least, provide a workable benchmark for DOR to calculate the average over 90 days. **Mr. Hoffman** reminded the Committee that there had been problems with the last legislation containing a trigger, but noted if the statute specified an average of an identifiable price it could serve as a benchmark to see whether the incentives would apply to a quarter. He suggested the Committee could set the trigger price $2/barrel higher to allow for the difference.

Senator Doherty noted since he had originally intended to set the benchmark at $25/barrel, he would prefer to leave it at $30/barrel.

Motion:

Accepting that suggestion as a friendly addition to his amendments, **Senator Doherty** asked that his previous motion be amended to include setting the trigger price at $30/barrel for average price over a calendar quarter of west Texas intermediate crude as published daily in the *Wall Street Journal*.

Discussion:

Jeff Martin asked that the way the average would be calculated be clarified. **Mr. Hoffman** said the *Wall Street Journal* posted that price daily. He asked if the trigger price would be a quarterly average. **Jeff Martin** noted that each daily price would be added up over the quarter and that sum would be divided by the number of days. **Senator Doherty** verified **Mr. Martin's** statement.

Vote:

The MOTION to AMEND SB 18 CARRIED UNANIMOUSLY (Exhibit #8 plus the addition accepted by **Senator Doherty** to use the quarterly average price per barrel of west Texas intermediate crude oil as reported daily in the *Wall Street Journal* to determine whether or not the price of oil had reached the threshold).

Discussion:

Senator Doherty distributed another set of amendments to SB 18 (Exhibit #9). He said the amendment would make the act contingent upon the completion of 50 wells and made it retroactive from June 30, 1995. He explained if the industry completed 50 wells by that date, they would be accorded the incentives in SB 18 retroactively. **Senator Doherty** said this amendment would allow the industry 1.5 years to reach the benchmark and would give them the opportunity to appeal to the Legislature if the weather had been horrible or there had been a shortage of drill rigs. He agreed that such a provision was similar to the window of opportunity the Legislature had established for coal, but added, however, that even though the industries are different, he had not arrived at a valid reason why they should be treated differently as far as tax policy.

Senator Doherty stated the incentives would not become effective until the oil companies produced, but when they produced, the act would be very much effective. He said the Legislature had established a viable policy with the window of opportunity afforded the coal industry. He added he did not agree that somebody could be penalized when they were receiving a gift; the oil companies were going to be given an opportunity to make money, and they were giving Montana an opportunity for economic development. He noted the oil industry and the state would be partners and stated that requiring the oil industry to drill a moderate number of wells in order to qualify, would not penalize them, since they would have the opportunity to something they did not currently have.

Motion:

Senator Doherty moved TO AMEND SB 18 (Exhibit #9).

Discussion:

Senator Doherty stated if the Committee expressed interest in changing the number of wells or the amount of time stipulated in the amendment, he would be willing to "dicker". He added, however, he thought the basic concept was a good idea.

Senator Halligan stated he, like **Senator Yellowtail**, wanted to include benchmarks in SB 18 and noted that he might support **Senator Doherty's** amendment if he did not believe that the perspective of the Legislature and the public had changed enough

to allow any Legislature to muster enough votes to redo tax incentives. He reminded the Committee that enhanced recovery projects are long-term, and the tax incentives are also calculated over the long-term life of the project; even if the total is only $1.59/barrel, the economic viability of a project would be figured from the first day on that incentive. **Senator Halligan** expressed his concern that if this amendment were adopted, the industry would have to figure as though no incentive existed at all, because it would establish a benchmark that would penalize some parts of the industry over others if they did not meet the expectations. He objected to this kind of benchmark, and stated that with the trigger price and the requirement that BOGC report to the Revenue Oversight Committee the industry is "pretty well covered".

Senator Towe pointed out that the industry projections include having 57 wells drilled by 1995 year end. He expressed his support for the amendment.

Vote:

The MOTION TO AMEND SB 18 FAILED by a ROLE CALL VOTE (Exhibit #9).

Discussion:

Senator Doherty complemented industry representatives on their professionalism in promptly providing him with straight forward information he had requested about Montana effective tax rates compared to Wyoming, North Dakota and Colorado. He stated, however, he would feel more comfortable in dealing with the numbers if he had somebody who could audit the companies' books. He explained the Committee might "be leaving a little bit too much money on the table". He stated he would like to reduce the rates in SB 18, but had not been able to arrive at any figures. He added he hoped to have some suggestions by the time SB 18 goes to the Senate floor, which would be the last chance to reduce those rates.

Senator Doherty noted that **Senator Halligan** had done a good job trying to target the incentives specifically. He said he would like to see the incentives in SB 18 directly attached to performance, but realized that idea did not have enough support in the Committee. He reiterated his belief that in providing an incentive, Montana may not have to reduce its tax rates as much as provided in SB 18.

In connection with **Senator Doherty's** statement, **Senator Towe** commented his biggest concern was the 18 month holiday SB 18 would accord new horizontal drilling. He stated that his concern was aggravated by the information that the other two states whose statutes make specific reference to horizontal drilling, have placed a limit on the amounts: Oklahoma law limits the holiday

until payback or 24 months which ever occurs first; Louisiana provides that the oil from a horizontal well is taxed at a lesser rate until the company doubles its investment. **Senator Towe** said he would at least like to see how those two states mechanically provide for that in their statutes, and noted that unfortunately Meridian Oil has not been able to obtain that information. He asked if the Committee was interested in considering limiting the holiday to 18 months or until the costs of drilling are recouped whichever is earlier.

Senator Halligan asked either **Don Hoffman** or an industry representative if they knew anything about the administrative costs connected to such a provision, or how they would audit financial information to know when payback would be reached by either an individual project or a field.

Mr. Hoffman responded DOR auditors have never concerned themselves with the concept of "payback". He noted that the concept was unique to the industry and indicated that at some point in time a company had recouped their costs on a well. He requested that if the Committee introduced the concept of "payback" into SB 18, DOR be given some guidance as to what standard should be adopted to determine when payback would be actually reached.

Senator Towe noted he did not know how the point of payback would be determined either. He said that was the reason he had asked to see the pertinent Oklahoma and Louisiana statutes.

Senator Van Valkenburg said he understood that payback within an 18 month period is unique to the geological formations in areas such as Louisiana or Oklahoma. He stated it was not even a matter of practical discussion in the geological formations found in Montana. He asked **Tom Richmond** if that was correct. **Mr. Richmond** responded that the concept of payback or recouping the expense of drilling could be found in Montana's "forced pooling" statute, 82-11 MCA. He stated that statute lists the kinds of things for which people who did not participate in the drilling are assessed a penalty.

Senator Van Valkenburg remarked **Mr. Richmond** was not addressing his question. **Senator Van Valkenburg** asked what the likelihood was that a horizontally drilled well in Montana was going to recover its cost of production in an 18 month period. **Mr. Richmond** said he could not answer that question because it was a geological function and depended upon the formation being drilled into. He noted that some wells in the Texas Austin Chalk paid off while the companies were drilling, but added in Montana there was nothing like that.

Senator Van Valkenburg asked what the likelihood was of that happening in Montana. **Mr. Richmond** said he had been told that the states forced pooling statute which has a 200 percent penalty would make almost all of the wells in the state uneconomical,

because those wells do not pay out at 200 percent. **Senator Van Valkenburg** said he did not know whether he and **Mr. Richmond** "were tracking".

Senator Towe asked how long it normally took for a payout to occur under the pooling statutes. **Mr. Richmond** said it really is dependent upon how much oil is produced. **Senator Towe** asked if payout could occur as early as 12 or 18 months. **Mr. Richmond** responded that in some cases payout could occur that early. He emphasized, however, that the time of payout is extremely variable, and added it was hard to assign dollar values on for enhanced recovery methods.

Senator Van Valkenburg asked an industry representative to respond to his question. **Bill Tulloch, Meridian Oil,** responded that Meridian oil planners estimate that at least three to five years would be necessary to even approach payback, at least at anticipated production levels. He defined payout to be the revenues recovered from the production stream against the actual cost or investment of drilling the well. **Mr. Tulloch** stated that Meridian is looking at an excess of $1 million per well in drilling cost and the company would really be pleasantly surprised, if some production levels were tapped that caused Meridian to recover its costs within 18 months. He emphasized Meridian certainly does not project that kind of production out of the wells it hoped to drill in Montana.

Mr. Tulloch reminded committee members that the 18 month holiday in SB 18 would only apply to the local net proceeds tax. He stated the oil companies are "in no way getting a holiday of any nature on the state severance tax", a fact which was made clear in the company's presentations to local residents, according to **Mr. Tulloch.** He said he remembered no expressed opposition to granting the additional six months on the local taxing structure. He emphasized the state would receive the full tax rate for new horizontal wells.

Senator Towe noted he still would like to see the Oklahoma and Louisiana statutes. He said he had no qualms about the industry's projections that payback would normally occur at three years. He stated certain circumstances exist in which it ought to be limited sooner, but noted that until the Committee has a better grasp of how to determine and define "payout", the Committee would not be in a position to include that concept in SB 18.

Motion:

Senator Halligan moved SB 18 DO PASS AS AMENDED.

Discussion:

Senator Yellowtail stated the "Committee ought to be wearing red suits and white whiskers today because we are about to deliver a

Christmas present to a special interest that has to be understood in the proper context of this special session". He reminded committee members that the "holiday season package for students and poor people and the elderly and the sick is not bright", and added he remained unconvinced that an emergency existed and that SB 18 was appropriate in this special session. Setting the appropriateness of SB 18 aside, **Senator Yellowtail** expressed skepticism about the type of tax incentive contained in SB 18. He stated "they seldom perform up to the advertised expectation as delivered by the applicant", and noted the applicants had already begun to backpeddle, an action which "belies their sincerity in their ability to deliver on what they have sold the public in eastern Montana". He stated the Legislature should make it public policy to grant special tax incentives subject to "reasonable and concrete benchmark requirements that they deliver on their rhetoric", when a special interest appeals to the Legislature for an incentive "justified by their public promises of some public benefit". **Senator Yellowtail** emphasized that he was not opposed to incentives if "there is some accountability for delivery". He concluded that SB 18 embodied "enormously bad public policy", and urged the Committee to resist.

Senator Gage said SB 18 would require companies to deliver before they receive; if no well was drilled as a result of SB 18, nothing would happen to the State's tax policy. He noted, however, if SB 18 did result in new activity, additional funds would be available to give to the poor people, schools, local governments and other groups that will be hurt this session. He emphasized that SB 18 would not affect the current revenues of current production, or the projections of what current oil wells are going to produce. **Senator Gage** stated "nothing of nothing is nothing" and that was what Montana would get without such legislation. He noted that Montana was in competition with other areas of the world as well as the nation. He said although costs had more to do with drilling programs progressing then many things, the costs involved were not today's costs, but those projected over the life of that well.

Senator Towe disagreed with **Senator Gage.** He said SB 18 addressed a new technology which would probably be more efficient and extract more minerals from the ground. He said the oil companies had asked the Legislature to grant them a tax break because that new technology was more expensive. He stated there had been no suggestion or evidence that the oil companies would not be drilling at the same rate without the tax break as they would with the tax break. According to **Senator Towe,** that represents a substantial loss of revenue. He expressed his concern that for the second time in five years, the oil industry had emerged from a special session called because of a financial crisis costing the people of Montana tax dollars and cuts in services with a substantial tax break. **Senator Towe** stated during a special session the time frame made it impossible either to get information from Louisiana and Oklahoma in order to see what other kinds of limitations should be considered or to really

evaluate SB 18 to discover what problems might exist. He stated the tax incentive issue could have been introduced in a the past general session, and it could have waited for the next session. He added it was a mistake to consider such an issue in a special session. He noted the oil industry had possibly intended to exploit the shorter time frame of a special session.

Senator Brown said SB 18 did not give anything to anybody, and added government could not give what it does not first take. He noted that if a positive response to the incentives would generate more revenue, the government would have more money to provide eyeglasses in the future. He stated the fact that a special legislative session is called and the Legislature may be forced to cut important services makes good political rhetoric, but has nothing to do with SB 18. According to **Senator Brown**, the bottom line on this issue is whether a person believed that the cost of doing business played an important role in companies' investment decisions, and was to take the chance that providing the incentives in SB 18 might encourage business and new development in Montana's future. He concluded if a person believed in that philosophy, they could vote for SB 18, if they did not, they could vote against SB 18.

Senator Grosfield stated he agreed with **Senators Brown** and **Gage**. He stated SB 18 would provide possible economic development and the potential for more tax revenue in Montana. He noted the Committee had been given a chart which used figures published in the Oil and Gas Journal demonstrating that horizontal drilling did not occur in Montana. He stated those numbers win credibility for the potential of new wells in the state, and stated he believed that SB 18 was good public policy.

Senator Van Valkenburg stated he had always believed that the best way to persuade and convince someone else of the legitimacy and need for things he finds in the best interest of Montana was being fair, open-minded and receptive to the ideas of others, particularly from other geographic regions and other political parties. He noted he had all the same concerns that **Senators Towe, Yellowtail** and others had expressed about the effects of this special session on the people of this state. He added, however, that the people who live in eastern Montana and along the Hi-line want to contribute to state services, want their local economies to grow, and want contribute in a responsible way to the State's needs. According to **Senator Van Valkenburg,** these residents were faced with competition and incentives provided in other states and nations. He said SB 18 represented a chance for those areas to experience some real and long-term economic growth. He expressed his belief that supporting something his own constituents may have a difficult time understanding might make it easier for someone from another part of the state to understand and support a position of his in the future. He stated he would support SB 18 for that reason.

Senator Doherty commented he would like to vote for SB 18

especially since **Senator Halligan** had attempted to "tie it down and make it a performance based and targeted incentive". He noted that those kinds of incentives might be the ones that work, although "trickle down has not really proven to be very successful". He stated, however, he, like **Senator Towe**, was bothered that SB 18 was being presented in a special session with its concomitant time restraints and inability to really review all alternatives. **Senator Doherty** noted oil is an interest which can martial its forces, go into the governor's office and get the call of a legislature expanded on the hope that something would happen in a region which is desperate for hope. He stated "nobody else can do that and nobody else has done that", and added that fact offended him.

Senator Halligan noted the "holiday package of cuts for education and human services, the disabled and students" was largely the gift of Mr. Natelson and the petition supporters and had nothing to do with the oil industry. He stated he was "attempting not to give away the farm" but "to provide some stability and predictability in future revenue sources in order to defuse some of the interest in cutting government, so that petition drives cannot have such a dramatic impact on the services Montanans cherish". He repeated the foundation of SB 18 reflected the criteria of the National Conference of State Legislatures and the incentives were performance based since their benefits would only accrue to new wells or enhanced production. **Senator Halligan** argued that the additional criteria and the trigger price would make it possible to track the performance of companies while keeping Montana's tax policy competitive with North Dakota and Wyoming. He noted that the incentives contained in SB 18 would not result in the snowball effect of "somebody going to another state and whining about tax incentives in Montana". He concluded SB 18 was constructed to allow Montana's tax policy to maintain its position in the "competitive level playing field".

Vote:

The DO PASS AS AMENDED MOTION FOR SB 18 CARRIED by ROLL CALL VOTE.

ROLL CALL

SENATE COMMITTEE TAXATION DATE December 3, 199

NAME	PRESENT	ABSENT	EXCUSED
Sen. Halligan, Chair	X		
Sen. Eck, Vice Chair	X		
Sen. Brown	X		
Sen. Doherty	X		
Sen. Gage	X		
Sen. Grosfield	X		
Sen. Harp	X		
Sen. Stang	X		
Sen. Towe	X		
Sen. Van Valkenburg	X		
Sen. Yellowtail	X		

SENATE STANDING COMMITTEE REPORT

December 4, 1993

MR. PRESIDENT:
We, your committee on Taxation having had under consideration Senate Bill No. 18 (first reading copy -- white), respectfully report that Senate Bill No. 18 be amended as follows and as so amended do pass.

Signed: _____
Senator Mike Halligan, Chair

That such amendments read:

1. Title, line 8.
Following: "2002;"
Insert: "PROVIDING THAT INCREMENTAL PRODUCTION FROM ENHANCED RECOVERY PROJECTS IS TAXED AT EXISTING HIGHER RATES IN CALENDAR QUARTERS IN WHICH THE PRICE PER BARREL OF OIL IS EQUAL TO OR GREATER THAN $30;"

2. Title, line 12.
Following: "RATES;"
Insert: "REQUIRING THAT THE BOARD ESTABLISH A FEE SCHEDULE TO DEFRAY THE EXPENSES FOR REVIEWING PROPOSED ENHANCED RECOVERY PROJECTS;"

3. Page 2.
Following: line 23
Insert: "The board of oil and gas conservation is required to establish by rule a fee schedule to defray the expenses associated with reviewing applications for enhanced recovery projects. The fee schedule adopted by the board must take into account the complexity of processing the application."

4. Page 5, line 14.
Following: "project"
Insert: ", by a well in primary recovery recompleted as a horizontally completed well,"

5. Page 5, line 17.
Strike: "or"

6. Page 5, line 23.
Strike: "."
Insert: "; or
(c) the commencement of the recompletion of a well as a horizontally completed well."

M- Amd. Coord.
SB Sec. of Senate

7. Page 6, line 18.
Following: "project"
Insert: ", of a recompletion of a well as a horizontally completed well,"

8. Page 6, line 19.
Following: "or"
Insert: "of an"

9. Page 6, line 20 and page 23, line 13.
Following: "writing"
Insert: "to the department of revenue"

10. Page 6, line 21 and page 23, line 13.
Strike: "The"
Insert: "In that certification, the"

11. Page 6, line 24.
Following: "used"
Insert: "by the department"

12. Page 7, line 14 and page 18, line 15.
Strike: "approved"
Insert: "certified"

13. Page 7, line 15 and page 18, line 16.
Following: "project"
Insert: "to the department"
Strike: "approval"
Insert: "certification"

14. Page 7, line 19.
Following: "delineated"
Insert: "in the certification"

15. Page 12, line 20.
Following: "(i)"
Insert: "except as provided in subsection (4),"

16. Page 13.
Following: line 17
Insert: "(4) (a) Incremental production from a new enhanced recovery project is subject to the tax rate imposed in subsection (2)(c)(i) or (2)(c)(ii) if the average price per barrel of oil as reported in the Wall Street Journal for west Texas intermediate crude oil during a calendar quarter is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as

determined in subsection (5), incremental production from a new enhanced recovery project is taxed as provided in subsection (2)(a) for production occurring in that quarter.

(b) Incremental production from an expanded enhanced recovery project is subject to the tax rate imposed in subsection (2)(c)(i) or (2)(c)(ii) if the average price per barrel of oil as reported in the Wall Street Journal for west Texas intermediate crude oil during a calendar quarter is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from an expanded enhanced recovery project is taxed as provided in subsection (2)(a) for production occurring in that quarter.

(5) For the purposes of subsections (4)(a) and (4)(b), the average price per barrel must be computed by dividing the sum of the daily price for west Texas intermediate crude oil as reported in the Wall Street Journal for the calendar quarter by the number of days in the quarter."

Renumber: subsequent subsections

17. Page 14, line 23.
Strike: "Production"
Insert: "New production"

18. Page 14, line 24.
Strike: "is"
Insert: "and incremental production from wells recompleted as horizontally completed wells are"

19. Page 15, lines 2 through 5.
Strike: ":" on line 2 through "(b)" on line 5

20. Page 18, line 2.
Following: "(c)"
Insert: "except as provided in subsection (4)(a),"

21. Page 19, line 15.
Strike: "(6)(a)(ii)"
Insert: "(8)(a)(ii)"

22. Page 20, line 21.
Following: "(e)"
Insert: "except as provided in subsection (4)(b),"

23. Page 20, line 25.
Strike: "(6)(a)(ii)"
Insert: "(8)(a)(ii)"

24. Page 22, line 14.
Following: "produced"
Insert: "by either a well in primary recovery recompleted as a horizontally completed well or"

25. Page 22, line 15.
Following: "project"
Insert: ", which volume of production is"

26. Page 22.
Following: line 16
Insert: "(A) the commencement of the recompletion of a well as a horizontally completed well;"
Renumber: subsequent subsections

27. Page 23, line 12.
Following: "project"
Insert: "or the recompletion of a well as a horizontally completed well"

28. Page 24.
Following: line 19
Insert: "(4) (a) Incremental production from a secondary recovery project is subject to the tax rate imposed in subsection (1)(c) if the average price per barrel of oil as reported in the Wall Street Journal for west Texas intermediate crude oil during a calendar quarter is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from a secondary recovery project is taxed as provided in subsection (1)(a) for production occurring in that quarter.

(b) Incremental production from a tertiary recovery project is subject to the tax rate imposed in subsection (1)(e) if the average price per barrel of oil as reported in the Wall Street Journal for west Texas intermediate crude oil during a calendar quarter is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from a tertiary recovery project is taxed as provided in subsection (1)(d) for production occurring in that quarter.

(5) For the purposes of subsections (4)(a) and (4)(b), the average price per barrel must be computed by dividing the sum of the daily price for west Texas intermediate crude oil as reported in the Wall Street Journal for the calendar quarter by the number of days in the quarter."
Renumber: subsequent subsections

29. Page 30, line 17.
Strike: "drilled"
Insert: "completed"

30. Page 48.
Following: line 11
Insert: "NEW SECTION. **Section 20. Fees for processing applications.** (1) The board shall establish a fee schedule to defray the expenses incurred for processing an application from an operator or producer of oil seeking approval of a new or expanded enhanced recovery project, as defined in 15-23-601 or 15-36-101. The fee must be paid by the owner or operator seeking approval of the project.

(2) The board shall, by rule, determine the amount of the fee based on the complexity of processing the application.

NEW SECTION. **Section 21. Reports by board of oil and gas conservation to revenue oversight committee.** The board of oil and gas conservation shall report at least once a year to the revenue oversight committee regarding the implementation of [this act]. The reports must include but are not limited to information regarding:

(1) the methods used to determine production decline rates;

(2) rules adopted to implement [this act];

(3) the number of enhanced recovery projects completed or anticipated to be completed in a year; and

(4) the number of horizontal wells completed or anticipated to be completed in a year and the method of recovery from the horizontal wells."
Renumber: subsequent sections

31. Page 48, line 12.
Following: "**instruction.**"
Insert: "(1)"

32. Page 48.
Following: line 15
Insert: "(2) [Section 20] is intended to be codified as an integral part of Title 82, chapter 11, part 1, and the provisions of Title 82, chapter 11, part 1, apply to [section 20]."

-END-

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Rule making auth. G

Amendments to Senate Bill No. 18
First Reading Copy

5
December 3, 1993
SB 18

Requested by Senator Halligan
For the Committee on Taxation

Prepared by Jeff Martin
December 2, 1993

1. Page 5, line 14.
Following: "project"
Insert: ", by a well in primary recovery recompleted as a horizontally completed well,"

2. Page 5, line 17.
Strike: "or"

3. Page 5, line 23.
Strike: "."
Insert: "; or
(c) the commencement of the recompletion of a well as a horizontally completed well."

4. Page 6, line 18.
Following: "project"
Insert: ", of a recompletion of a well as a horizontally completed well,"

5. Page 6, line 19.
Following: "or"
Insert: "of an"

6. Page 6, line 20 and page 23, line 13.
Following: "writing"
Insert: "to the department of revenue"

7. Page 6, line 21 and page 23, line 13.
Strike: "The"
Insert: "In that certification, the"

8. Page 6, line 24.
Following: "used"
Insert: "by the department"

9. Page 7, line 14 and page 18, line 15.
Strike: "approved"
Insert: "certified"

10. Page 7, line 15 and page 18, line 16.
Following: "project"
Insert: "to the department"
Strike: "approval"
Insert: "certification"

11. Page 7, line 19.

Following: "delineated"
Insert: "in the certification"

12. Page 14, line 23.
Strike: "Production"
Insert: "New production"

13. Page 14, line 24.
Strike: "is"
Insert: "and incremental production from wells recompleted as horizontally completed wells are"

14. Page 15, lines 2 through 5.
Strike: ":" on line 2 through "(b)" on line 5

15. Page 22, line 14.
Following: "produced"
Insert: "by either a well in primary recovery recompleted as a horizontally completed well or"

16. Page 22, line 15.
Following: "project"
Insert: ", which volume of production is"

17. Page 22.
Following: line 16
Insert: "(A) the commencement of the recompletion of a well as a horizontally completed well;"
Renumber: subsequent subsections

18. Page 23, line 12.
Following: "project"
Insert: "or the recompletion of a well as a horizontally completed well"

19. Page 30, line 17.
Strike: "drilled"
Insert: "completed"

20. Page 48.
Following: line 11
Insert: "NEW SECTION. **Section 20. Reports by board of oil and gas conservation to revenue oversight committee.** The board of oil and gas conservation shall report at least once a year to the revenue oversight committee regarding the implementation of [this act]. The reports must include but are not limited to information regarding:

(1) the methods used to determine production decline rates;

(2) rules adopted to implement [this act];

(3) the number of enhanced recovery projects completed or anticipated to be completed in a year; and

(4) the number of horizontal wells completed or anticipated to be completed in a year and the method of recovery from the horizontal wells."

EXHIBIT 5
12-3-93
SB 18

Renumber: subsequent sections

Failed Roll Call V
6
December 3, 19
SB18

Amendments to Senate Bill No. 18
First Reading Copy

Requested by Senator Towe
For the Committee on Taxation

Prepared by Jeff Martin
December 2, 1993

1. Title, line 12.
Following: "RATES;"
Insert: "REQUIRING THE BOARD OF OIL AND GAS CONSERVATION TO CERTIFY TO THE GOVERNOR BY DECEMBER 31 OF EACH YEAR THE NUMBER OF HORIZONTALLY COMPLETED WELLS AND THE NUMBER OF WELLS COMPLETED IN ENHANCED RECOVERY PROJECTS SINCE JANUARY 1, 1994;"

2. Title, line 17.
Following: the first "DATE"
Insert: ","
Strike: "AND"
Following: the second "DATE"
Insert: ", AND TERMINATION DATES"

3. Page 2, line 24.
Following: line 23
Insert: "The board of oil and gas conservation is also authorized to adopt rules on the dissemination of information concerning the number of horizontally completed wells and the number of wells completed in enhanced recovery projects as well as the number of wells anticipated to be completed. Because this bill contains a number of termination dates based on the completion of wells, it is the intent of the legislature that the board of oil and gas conservation develop rules to ensure that the oil industry is fully informed on the number of completed wells and on the status of wells anticipated to be completed. This information will ensure that the oil industry will have the maximum opportunity to develop enhanced recovery projects and to achieve the goals of increased oil production in the state."

4. Page 48.
Following: line 11
Insert: "NEW SECTION. **Section 20. Certification of enhanced recovery projects -- rules.** The board of oil and gas conservation shall certify to the governor by December 31 of each year the number of horizontally completed wells since January 1, 1994, and the number of wells completed since January 1, 1994, in approved new or expanded enhanced recovery projects. The board may adopt rules to disseminate information on the number of completed wells and on the number of wells anticipated to be completed in a manner that the board considers appropriate."
Renumber: subsequent sections

5. Page 49.
Following: line 1
Insert: "NEW SECTION. **Section 24. Termination -- contingent termination.** (1) [This act] terminates January 1, 2003.

(2) If the board of oil and gas conservation has certified to the governor under [section 20] that the total number of wells completed since January 1, 1994, is less than:

(a) 17 wells by December 31, 1994, then [sections 1 and 6] terminate December 31, 1994;

(b) 45 wells by December 31, 1995, then [sections 1 and 6] terminate December 31, 1995;

(c) 76 wells by December 31, 1996, then [sections 1 and 6] terminate December 31, 1996;

(d) 104 wells by December 31, 1997, then [sections 1 and 6] terminate December 31, 1997; and

(e) 126 wells by December 31, 1998, then [sections 1 and 6] terminate December 31, 1998.

State of Montana

Marc Racicot, Governor

7
December 3, 199
Senate Bill 18

Department of Revenue
Mick Robinson, Director

P.O. Box 202701
Helena, Montana 59620-2701

December 3, 1993

TO: Senator Doherty
Senate Taxation Committee

FROM: Mick Robinson, Director
Department of Revenue

RE: Senate Bill 18 - Oil Incentives

The Department of Revenue will not be shifting tax administration duties by allowing the Board of Oil and Gas Conservation to be responsible for approving new or expanded secondary and tertiary projects in Senate Bill 18. The Department of Revenue's expertise lies in making sure the oil companies report and pay their taxes correctly. The Board of Oil and Gas Conservation is the state entity with the expertise to approve the projects and to establish the production decline rates.

The Department of Revenue will work closely with the Board of Oil and Gas Conservation to utilize each entities expertise in developing the rules to administer this legislation. The Department of Revenue will continue to administer all the oil taxes. The Board of Oil and Gas Conservation will be using their expertise and professional judgement in establishing the production decline curves. These decline curves are important for the proposed tax incentives so the Department of Revenue can determine the appropriate tax rate; however, determining the production decline curves are outside the technical knowledge and skills of tax administrators and auditors.

8
December 3, 1993
SB 18

Amendments to Senate Bill No. 18
First Reading Copy

Requested by Senator Doherty
For the Committee on Taxation

Prepared by Jeff Martin
December 2, 1993

1. Title, line 8.
Following: "2002;"
Insert: "PROVIDING THAT INCREMENTAL PRODUCTION FROM ENHANCED RECOVERY PROJECTS IS TAXED AT EXISTING HIGHER RATES IN CALENDAR QUARTERS IN WHICH THE PRICE PER BARREL OF OIL IS EQUAL TO OR GREATER THAN $30;"

2. Page 12, line 20.
Following: "(i)"
Insert: "except as provided in subsection (4),"

3. Page 13.
Following: line 17
Insert: "(4) (a) Incremental production from a new enhanced recovery project is subject to the tax rate imposed in subsection (2)(c)(i) or (2)(c)(ii) if the average price per barrel received during a quarter from production occurring in an approved project area is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from a new enhanced recovery project is taxed as provided in subsection (2)(a) for production occurring in that quarter.

(b) Incremental production from an expanded enhanced recovery project is subject to the tax rate imposed in subsection (2)(c)(i) or (2)(c)(ii) if the average price per barrel received during a quarter from production occurring in an approved project area is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from an expanded enhanced recovery project is taxed as provided in subsection (2)(a) for production occurring in that quarter.

(5) The average price per barrel must be computed by dividing the total gross value of product received from all petroleum and other mineral or crude oil sold in the quarter from the project area in which incremental production occurs by the number of barrels sold in the quarter from the project area in which incremental production occurs."
Renumber: subsequent subsections

4. Page 18, line 2.
Following: "(c)"
Insert: "except as provided in subsection (4)(a),"

5. Page 19, line 15.

EXHIBIT 8
12-3-93
SB 18

Strike: "(6)(a)(i)"
Insert: "(8)(a)(ii)"

6. Page 20, line 21.
Following: "(e)"
Insert: "except as provided in subsection (4)(b),"

7. Page 20, line 25.
Strike: "(6)(a)(ii)"
Insert: "(8)(a)(ii)"

8. Page 24.
Following: line 19
Insert: "(4) (a) Incremental production from a secondary recovery project is subject to the tax rate imposed in subsection (1)(c) if the average price per barrel received during a quarter from production occurring in an approved project area is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from a secondary recovery project is taxed as provided in subsection (1)(a) for production occurring in that quarter.

(b) Incremental production from a tertiary recovery project is subject to the tax rate imposed in subsection (1)(d) if the average price per barrel received during a quarter from production occurring in an approved project area is less than $30 a barrel. If the price of oil is equal to or greater than $30 per barrel in a calendar quarter as determined in subsection (5), incremental production from a tertiary recovery project is taxed as provided in subsection (1)(a) for production occurring in that quarter.

(5) For the purposes of subsections (4)(a) and (4)(b), the average price per barrel of oil must be computed by dividing the total gross value of product received from all petroleum and other mineral or crude oil sold in the quarter from the lease or unitized area in which incremental production occurs by the number of barrels sold in the quarter from the lease or unitized area in which incremental production occurs."
Renumber: subsequent subsections

HEARING ON HOUSE BILL 73

Opening Statement by Sponsor: REP. RED MENAHAN, HD 67, Anaconda, said the bill is simply a revision of the low income tax credit program. It is another way to address the problem of people being forced out of their homes by huge tax increases. The exemptions are raised to $25,000 for single taxpayers and $30,000 for married couples. It extends the application deadline to March 1, 1994. The bill does not address the elderly homeowner credit program.

Proponents' Testimony: There were no proponents.

Opponents' Testimony: There were no opponents.

Questions From Committee Members and Responses: There were no questions.

Closing by Sponsor: REP. MENAHAN closed by noting the Committee may wish to adjust the maximum exemption figures after they receive the fiscal note.

HEARING ON SENATE BILL 18

Opening Statement by Sponsor: SEN. MIKE HALLIGAN, SD 92, Missoula, said the bill represents an incentive to development of horizontal secondary and tertiary oil drilling in Montana. He said information he gathered at the National Conference of State Legislatures earlier this year pinpointed the cannibalistic methods used between states in order to entice businesses to leave one state and move to another. Low tax bases are the main incentive for that migration. General tax incentives do not seem to be as attractive to oil companies as do targeted incentives such as development of new activity. A level playing field should be established for the new businesses in relation to existing businesses. Environmental and other regulations should not be waived. Incentives should be offered to industries that pay higher than average weekly wages. The industry should be capable of providing health care, retirement, and other benefits to its employees. Performance should be measurable and the incentives should terminate at some point in time.

SB 18 meets all the aforementioned criteria. It provides a specific incentive for development of new drilling, it does not waive any environmental or other regulations, the industry is fiscally sound and offers a substantial wage and benefits package to its employees. Development of new drilling is very measurable and there is a sunset on the bill in eight years.

Horizontal drilling costs two to three times more than regular drilling procedures. The state severance tax remains the same. The incentive is in the form of a eighteen month holiday on net proceeds tax for horizontal drilling specifically. For secondary production there is reduction in the local government severance tax (LGST) to 8.5% and 7% to 5%. The state severance tax is reduced from 5% to 3%. The LGST on the incremental increase in production from new or expanded tertiary recovery is reduced from 5% to 2%. The net proceeds tax will drop to 3.3% on that incremental production.

Another important component of the bill, added by the Senate, is the trigger provision. Once the price of West Texas crude oil reaches $30 a barrel for a quarter, the incentive is dropped. When the price drops below $30 for a full quarter, the incentive is reinstated. The Senate Taxation Committee had concerns about monitoring provisions. It allowed the Board of Oil and Gas Conservation to increase fees to provide for new staff for the monitoring process.

The bill is timely and it does not affect existing revenues. The incentive only applies to the incremental production increase above existing production regardless if it is secondary or tertiary production.

Proponents' Testimony:

Stan Kaleczyc, Meridian Oil, presented testimony in support of the bill (Exhibit #1).

Perry Pearce, Meridian Oil, presented testimony in support of the bill (Exhibit #2).

Jerome Anderson, Shell Western Energy and Production, Inc., presented testimony in support of the bill (Exhibit #3).

Bob Sheffield, Shell Western Energy and Production, Inc., presented testimony in support of the bill (Exhibits #4 and #4a).

Gail Abercrombie, Montana Petroleum Association, presented testimony in support of the bill (Exhibit #5).

Peggy Trenk, Western Environmental Trade Association, presented testimony in support of the bill (Exhibit #6).

Dave Johnson, President, Montana Petroleum Association, presented testimony in support of the bill (Exhibit #7).

James Tutwiler, Montana Chamber of Commerce, said SB 18 is a jobs bill and a revenue bill. It will make Montana more competitive and will attract capital investment to the state.

Dennis Iverson, Northern Montana Oil and Gas Association, an organization of small and independent oil and gas producers, said this is a timely and important bill. It will allow for recapture of oil and gas revenues. It establishes good environmental policy and promotes the best conservation techniques. It is a good bill and timely public policy.

Sue Olson, Mussellshell County Commissioner, and President, Montana Oil, Gas, and Coal Counties Association, spoke in support of the bill saying the counties have suffered through many years of declining oil production and the associated shrinkage of the LGST every year. The bill will promote new and increased oil production in the counties and will provide a major tax benefit to the counties and the state. Because of the increased costs and time involved in horizontal drilling, it is fair to give the companies the incentives which will help them recover their costs. The counties will benefit from increased drilling in many ways: local economies are impacted by additional jobs, property and income tax receipts, and increases in business activity. She urged the Committee to support the bill.

Del Kenister, Economic Development Groups, Baker, echoed the previous testimony and urged the Committee to support the bill and the associated economic development it could provide for the eastern half of the state.

Dave Cramer, Dave's Hot Oil Service, Sidney, said his income is half of what it was when the oil business was flourishing in eastern Montana. School funds have suffered as well as all economic aspects of the oil impacted counties.

John Pigg, HRP Oil Properties, Sidney, said many changes have occurred in eastern Montana since the decline of oil business in 1981. Over 450,000 people in the oil industry have lost their jobs since 1981 and many businesses have closed. Increased drilling will provide a badly needed economic boost for local landowners, businesses, schools, cities and counties in eastern Montana. The oil businesses must be shown that Montana wants to attract business and be competitive with neighboring states.

Don Franz, Franz Construction, Sidney, said he has worked the oil fields in Montana for years as a dirt contractor. North Dakota has considerably more drilling activity than Montana at present. He noted over 70% of his business is done in North Dakota at this time. His Montana work is mostly all restoration work. Passage of SB 18 will encourage more drilling in the state which will be of great benefit to the counties in eastern Montana and the state.

Rocky Gorder, B & G Roustabout, said he was speaking on behalf of 16 other companies that drill in North Dakota and Montana. The passage of SB 18 would be a great economic boon to the companies, the local towns, schools, counties, and people. He urged the Committee to support the bill.

Robert Marquiss, Updike Brothers, Inc., Sidney, said the bill would be a great help to businesses and the economy in Sidney and eastern Montana.

David Cassidy, rancher and businessman in four eastern Montana counties, said his business taxes increased in all four counties this past year. This bill provides necessary incentives to get sorely needed business back into the eastern part of the state.

Don Reiger, Chairman, Fallon County Commissioners, Baker, agreed with the previous testimony. He said morale is down among employees of all eastern Montana businesses. This bill will provide badly needed economic development for the area.

REPS. FELAND, FOSTER, TUNBY, GILBERT AND HANSON all asked to be listed as proponents for the bill.

Opponents' Testimony: There were no opponents.

Informational Testimony:

Don Hoffman, Department of Revenue (DOR), presented proposed amendments clarifying the language added to the bill in the Senate. The amendments make it clear that gas production is not included in the bill and also clarifies the trigger mechanism re West Texas crude oil prices (Exhibit #8).

Questions From Committee Members and Responses:

REP. RANEY asked if water used to flood the horizontal wells would escape into other aquifers.

Mr. Sheffield said the flooding procedures are highly regulated by Montana law. He described the procedures and protections built into that law.

REP. RANEY asked what percentage of the total production takes place in the first 18 months.

Mr. Sheffield replied in the first 18 months of an average production well there would be approximately 40,000 barrels produced out of a total estimated production of 200,000 barrels.

REP. HARPER expressed concern about the shift in responsibility from DOR to the Board of Oil and Gas Conservation.

SEN. HALLIGAN said the Senate also had some concerns but the bill has been amended to make the shared responsibilities workable. DOR will still make the final decision regarding the tax rate, but the Board has the expertise to determine the declining rates in the existing oil fields. The Board has no authority in setting the tax policy.

Mr. Sheffield pointed out that decline curve technique is a well known science and is not based on conjecture.

A protracted discussion was held regarding responsibilities of the Oil and Gas Board, DOR, and decline curves and rates.

REP. RANEY said he was concerned that the Oil and Gas Board could deem any well a horizontal well according to the provisions of the bill.

Mr. Tulloch said current definitions define the range of angle that pertains to horizontal wells. He said that definition could be changed in the future as technology expands; however, the Board has specific guidelines and scientific data parameters that they must abide by.

Closing by Sponsor:

SEN. HALLIGAN closed saying this is not a Meridian Oil/Shell Oil bill. The small independent producers are excited about the bill and anxious to learn the technology from the large producers. He said the bill will not cause any economic or tax warfare as its provisions are midway between rates in Wyoming and North Dakota. The bill has been subjected to intense scrutiny and a finely honed performance model has resulted. There are good monitoring provisions built into the bill, it is environmentally sound, the tax incentives are cost effective, existing revenues are protected, and future income is guaranteed.

EXECUTIVE ACTION ON SENATE BILL 18

Motion: **REP. FELAND MOVED SB 18 BE CONCURRED IN.**

Motion/Vote: **REP. FELAND MOVED TO ADOPT THE DOR AMENDMENTS (EXHIBIT #8).** The motion carried unanimously.

Motion/Vote: **REP. FELAND MOVED SB 18 BE CONCURRED IN AS AMENDED.** The motion carried unanimously.

EXECUTIVE ACTION ON HOUSE BILL 53

Motion: **REP. RANEY MOVED HB 53 DO PASS.**

Discussion: **REP. RANEY** said he had talked with the Legislative Auditor before drafting the bill and was assured the Auditor's office could handle the work associated with the bill. The letter (Exhibit #9) indicates that, upon careful review, that will not be possible without an appropriation. He said he hoped

HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL DATE 12/10/93

NAME	PRESENT	ABSENT	EXCUSED
REP. GILBERT, CHAIRMAN	✓		
REP. FOSTER	✓		
REP. HARRINGTON		✓	
REP. ANDERSON	✓		
REP. BOHLINGER	✓		
REP. DOLEZAL		✓	
REP. DRISCOLL	✓		
REP. ELLIOTT		✓	
REP. FELAND	✓		
REP. HANSON	✓		
REP. HARPER	✓		
REP. HIBBARD	✓		
REP. KELLER	✓		
REP. McCAFFREE	✓		
REP. McCARTHY		✓	
REP. NELSON	✓		
REP. ORR	✓		
REP. RANEY	✓		
REP. REAM	✓		
REP. TUNBY	✓		

HOUSE STANDING COMMITTEE REPORT

December 10, 1993

Mr. Speaker: We, the committee on **Taxation** report that **Senate Bill 18** (third reading copy -- blue) **be concurred in as amended.**

Signed: Bob Gilbert

Bob Gilbert, Chair

And, that such amendments read: **Carried by: Rep. Gilbert**

1. Page 5, line 13.
Following: "production wells,"
Insert: "the recompletion of existing wells as horizontally completed wells,"

2. Page 5, line 14.
Following: "of"
Insert: "an"

3. Page 8, line 1
Strike: "natural gas,"
Following: "petroleum"
Strike: "."

4. Page 9, line 17.
Following: "new"
Insert: "production, production from horizontally completed wells,"

5. Page 9, line 19.
Page 11, lines 1 and 6.
Page 12, lines 16 and 17.
Page 13, lines 8 and 11.
Page 17, line 17.
Page 33, line 21.
Page 34, line 11.
Page 35, lines 16 and 24.

sl. 12-10-93

Committee V

Page 36, lines 6 and 21.
Page 37, line 11.
Page 38, line 19.
Page 40, line 15.
Page 44, line 13.
Page 46, line 15.
Page 50, line 9.
Following: "production"
Insert: ", production from horizontally completed wells,"

6. Page 9, line 25.
Following: "oil"
Insert: ", production from horizontally completed wells,"

7. Page 12, line 2.
Following: "production"
Insert: ", for production from horizontally completed wells,"

8. Page 15, line 16.
Page 28, line 2.
Following: "DAYS"
Insert: "on which the price was reported"

9. Page 16, line 22.
Strike: "NEW PRODUCTION"
Insert: "Production"

10. Page 17, line 15.
Following: "of"
Insert: "taxes on"
Following: "new"
Insert: "production, production from horizontally completed wells,"

11. Page 17, line 16.
Strike: "taxes"

12. Page 32, line 3.
Following: "of"
Insert: "taxes levied on"
Following: "production"
Insert: ", production from horizontally completed wells,"

13. Page 32, line 4.
Strike: "taxes levied"

14. Page 32, line 20.
Following: "of"

Insert: "taxes levied on"

15. Page 32, line 21.
Following: "production"
Insert: ", production from horizontally completed wells,"
Strike: "taxes levied"

16. Page 33, line 20.
Following: "of"
Insert: "taxes levied on"

17. Page 33, line 22.
Strike: "taxes levied"

18. Page 34, line 10.
Following: "of"
Insert: "taxes levied on"

19. Page 34, line 11.
Strike: "taxes levied"

20. Page 35, line 15.
Following: "of"
Insert: "taxes levied on"

21. Page 35, line 16.
Strike: "taxes levied"

22. Page 35, line 23.
Following: "of"
Insert: "taxes levied on"

23. Page 35, line 25.
Strike: "taxes levied"

24. Page 36, line 5.
Following: "of"
Insert: "taxes levied on"

25. Page 36, line 7.
Strike: "taxes levied"

26. Page 36, line 21.
Following: "of"
Insert: "taxes levied on"

27. Page 36, line 22.
Strike: "taxes levied"

28. Page 37, line 10.
Following: "of"
Insert: "taxes levied on"

29. Page 37, line 11.
Strike: "taxes levied"

30. Page 38, line 18.
Following: "of"
Insert: "taxes levied on"

31. Page 38, line 19.
Strike: "taxes levied"

-END-

EXHIBIT 4
DATE 1/10/97
SB 18

Proposed Incentives

To Attract Capital Investment

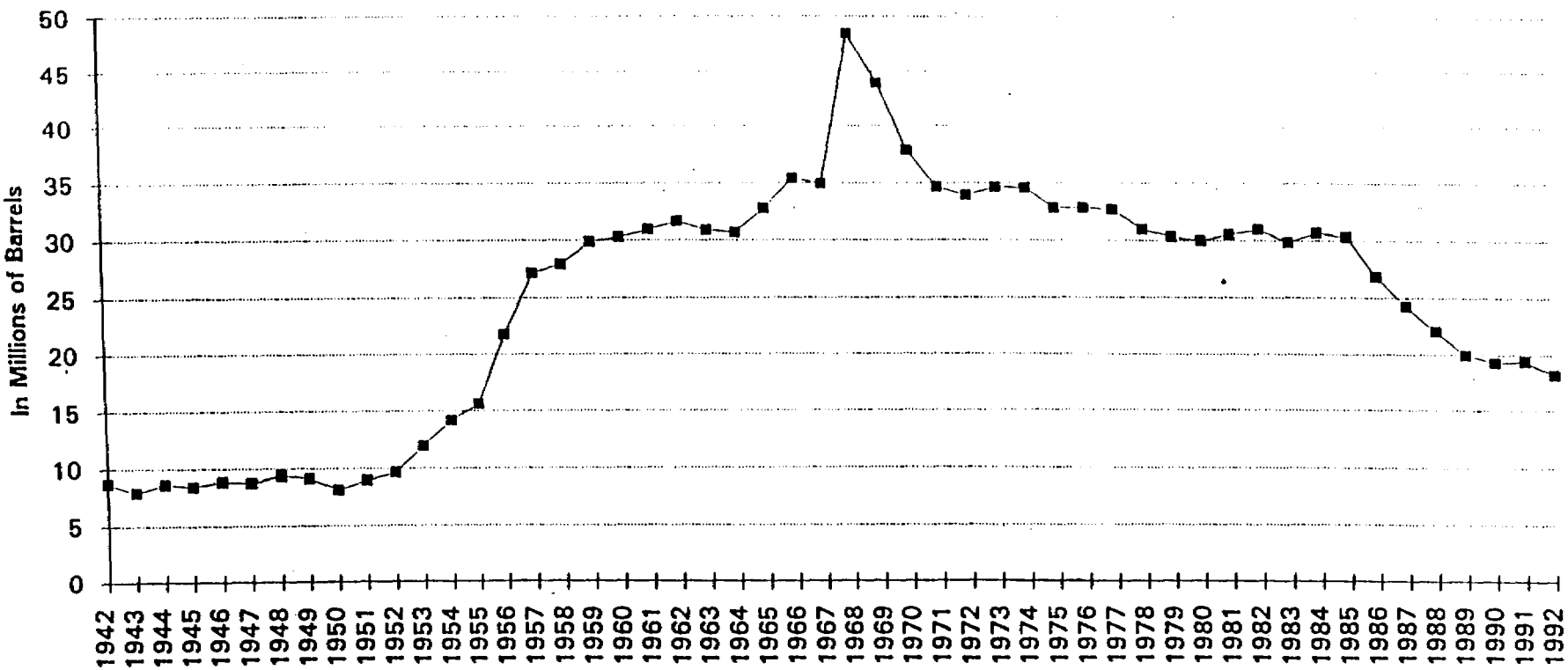
In Montana

For

New Drilling And

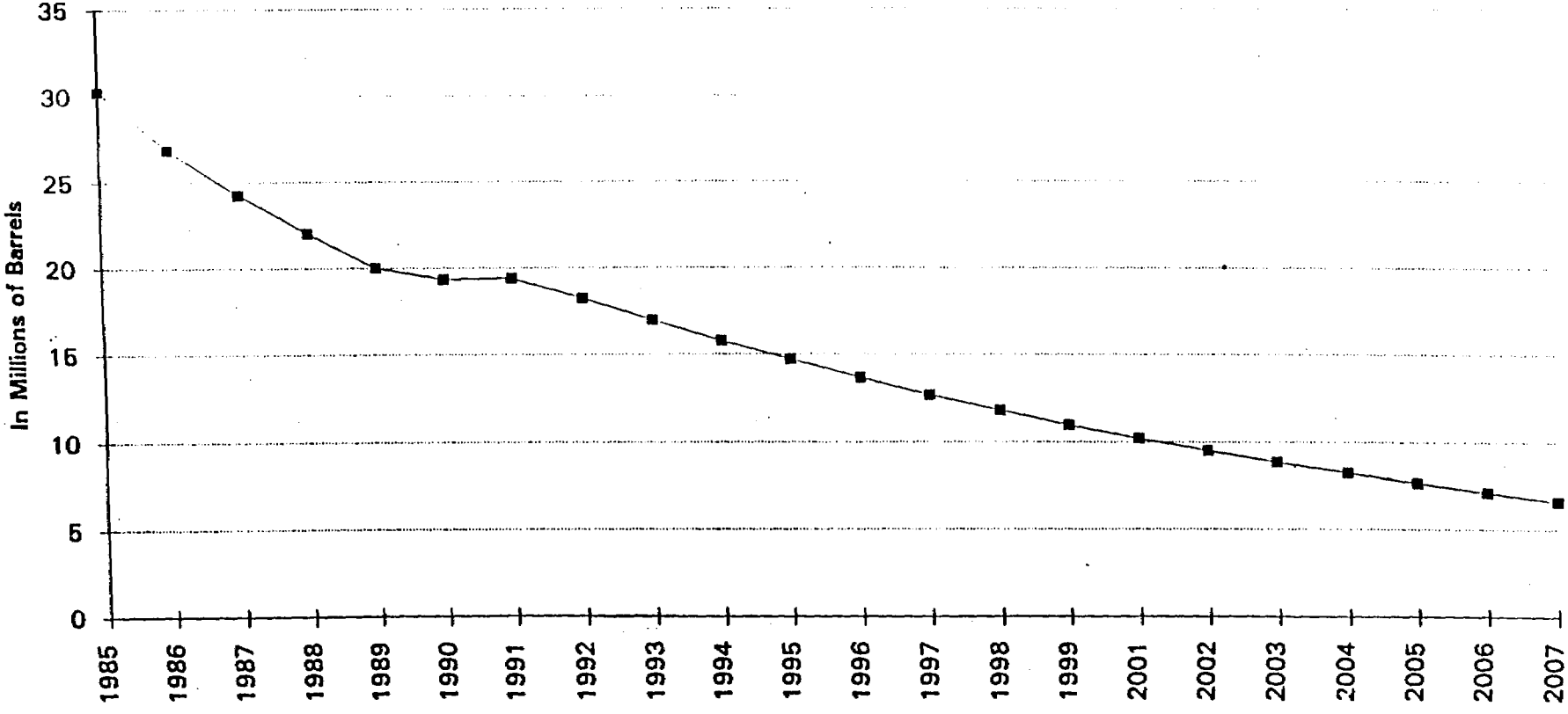
Enhanced Oil Production

MONTANA TOTAL CRUDE OIL PRODUCTION



12-10-93
SB 18

MONTANA OIL PRODUCTION DECLINE PROJECTION



A PROPOSAL FOR MONTANA

- An extension of the current Net Proceeds Tax holiday from 12 to 18 months for horizontal well production from wells drilled after January 1, 1994. This incentive would encourage the drilling of these very expensive and risky wells. New vertical wells drilled after January 1, 1994, would continue to receive the current 12 month holiday.

- A reduction in the Local Government Severance Tax rate or the Net Proceeds Tax, whichever is applicable from 8.4% or 7%, respectively, to 5.0% on the incremental increase in production from new or expanded secondary recovery projects effective January 1, 1994, and a reduction in the State Severance Tax from 5.0% to 3.0% on this production.

- A reduction in the Local Government Severance Tax rate or the Net Proceeds Tax rate, whichever is applicable, from 5.0% or 7%, respectively, to 3.30% on the incremental increase in production from new or expanded tertiary recovery projects effective January 1, 1994, and a reduction in the State Severance Tax from 2.5% to 2.0% on this production.

12-10-93
SB 18

Montana tax rates on OIL production:

	From wells drilled prior to July 1, 1985		From wells drilled after to July 1, 1985	
	CURRENT	PROPOSED	CURRENT	PROPOSED
Severance	5.00%	5.00%	5.00%	5.00%
Secondary	5.00%	3.00% *	5.00%	3.00% *
Tertiary	2.50%	2.00% *	2.50%	2.00% *
RITT	0.50%	0.50%	0.50%	0.50%
Privilege & License	0.20%	0.20%	0.20%	0.20%
LGST	8.40%	8.40%		
Secondary	8.40%	5.00% *		
Tertiary	5.00%	3.30% *		
Strippers	5.00%	5.00%		
Non-working int.	12.50%	12.50%		
Net Proceeds **			7.00%	7.00%
Secondary			7.00%	5.00% *
Tertiary			7.00%	3.30% *
TOTALS (working int.)				
Oil: Regular	14.10%	14.10%	12.70%	12.70%
Secondary	14.10%	8.70% *	12.70%	8.70% *
Tertiary	8.20%	6.00% *	10.20%	6.00% *
Stripper	10.70%	10.70%	12.70%	12.70%
All new wells:				
First 12 months of production, total rate:			5.70%	5.70%
Subsequent production, total tax rate:			12.70%	12.70%
New horizontal wells				
Months 13-18 of production, total rate:			12.70%	5.70% *
Subsequent production, total tax rate			12.70%	12.70%

Tribal royalties are exempt from taxation.

This chart does NOT include the various 7% surtax approved by the 1992 special session. The surtax applies to state severance, LGST, RITT and privilege and license taxes for one year of production. The production year and tax year varies with each tax.

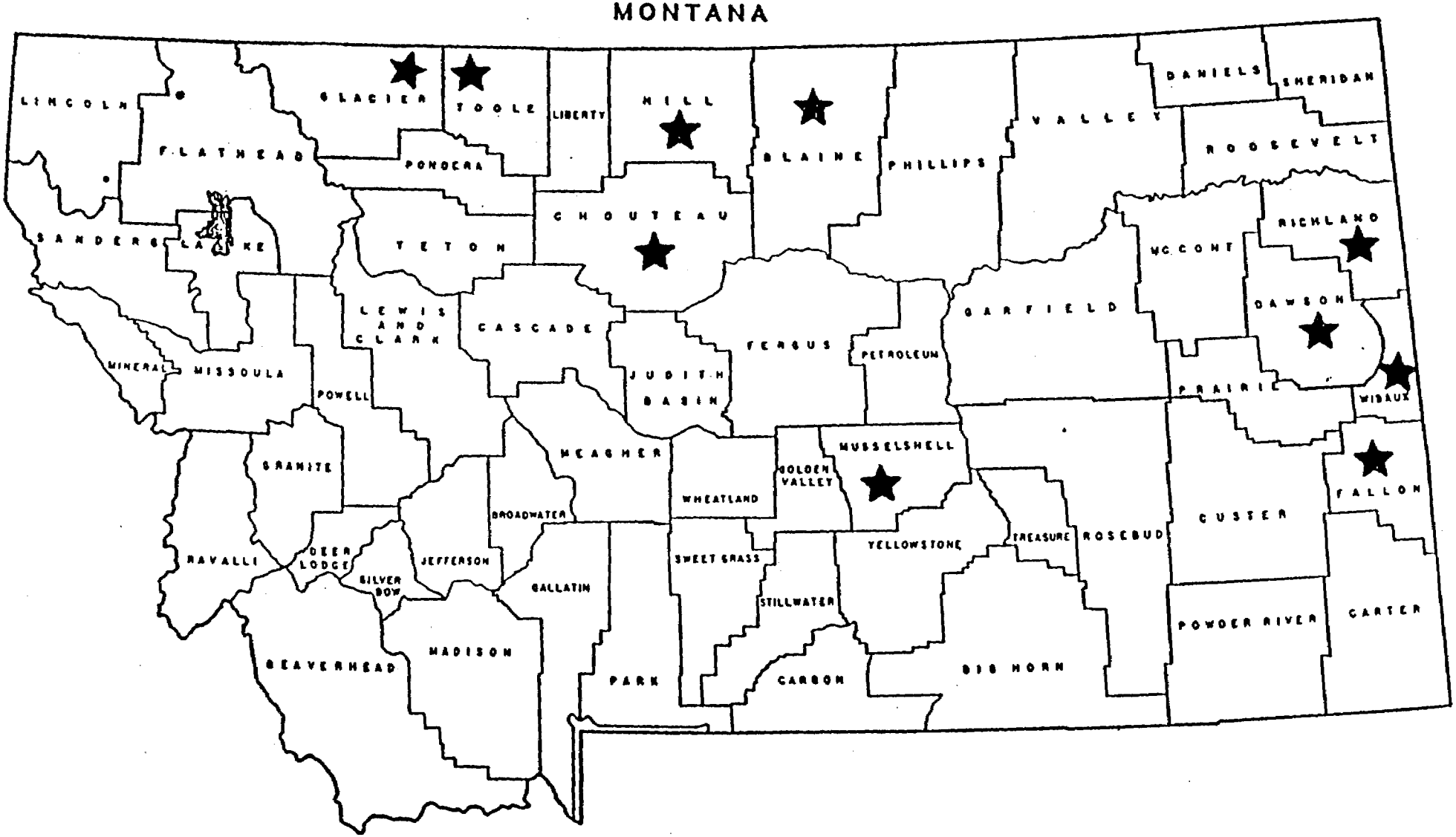
---

* Denotes change from current

** The net proceeds tax on post-1985 wells is actually a flat rate on gross, but is still codified as net proceeds. New wells receive holiday from net proceeds tax for initial production as follows:

a. first 12 months for conventional vertical completions
b. first 18 months for horizontal completions

MONTANA


LINCOLN
FLATHEAD
GLACIER
TOOLE
LIBERTY
HILL
BLAINE
PHILLIPS
VALLEY
DANIELS
SHERIDAN
ROOSEVELT
PONDERA
CHOUTEAU
SANDERS
LAKE
TETON
MC CONE
RICHLAND
GARFIELD
DAWSON
LEWIS AND CLARK
CASCADE
FERGUS
PETROLEUM
PRAIRIE
WIBAUX
MINERAL
MISSOULA
POWELL
JUDITH BASIN
MEAGHER
MUSSELSHELL
GOLDEN VALLEY
GRANITE
WHEATLAND
FALLON
BROADWATER
CUSTER
RAVALLI
DEER LODGE
JEFFERSON
SILVER BOW
GALLATIN
SWEET GRASS
YELLOWSTONE
TREASURE
ROSEBUD
STILLWATER
POWDER RIVER
CARTER
BEAVERHEAD
MADISON
PARK
CARBON
BIG HORN

12-10-93
SB 18

COMBINED
MERIDIAN OIL INC. and
SHELL WESTERN E & P

MONTANA
PROPOSED CAPITAL DEVELOPMENT
AND
PROJECTED WELL COMPLETIONS

YEAR	INVESTMENT ($ MILLIONS)	# WELLS COMPLETIONS
1994	$ 22.450	22
1995	36.150	35
1996	30.750	31
1997	28.500	28
1998	23.500	22
	$ 141.350	138

ANNUAL PROJECTED INCREASED REVENUES FROM PROPOSED INCENTIVES

Year	State Taxes	Royalties	Local Taxes	Total
1994	$507,562	$120,088	$259,225	$886,875
1995	$1,261,036	$417,273	$738,229	$2,416,538
1996	$1,978,075	$739,284	$1,547,693	$4,265,052
1997	$2,578,146	$1,019,929	$2,326,625	$5,924,700
1998	$3,057,702	$1,216,401	$2,977,044	$7,251,147
1999	$3,087,210	$1,158,280	$3,598,782	$7,844,272
2000	$2,846,699	$1,020,804	$3,729,774	$7,597,277
2001	$2,684,843	$945,100	$3,516,449	$7,146,392
2002	$2,559,730	$897,074	$3,352,432	$6,809,236
2003	$2,457,185	$865,081	$3,216,195	$6,538,461
2004	$2,366,215	$843,472	$3,061,656	$6,271,343
2005	$2,261,140	$828,439	$2,960,025	$6,049,604
2006	$2,189,991	$817,122	$2,726,748	$5,733,861
2007	$2,019,209	$807,569	$2,644,831	$5,471,609
2008	$1,918,397	$798,133	$2,504,057	$5,220,587
2009	$1,657,331	$760,226	$2,161,212	$4,578,769
2010	$1,360,131	$722,125	$1,802,620	$3,884,876
2011	$1,102,545	$685,931	$1,468,421	$3,256,897
2012	$874,211	$651,552	$1,172,906	$2,698,669
2013	$779,232	$618,901	$1,048,532	$2,446,665
2014	$739,247	$587,891	$1,046,348	$2,373,486
2016	$739,457	$558,430	$984,809	$2,282,696
2018	$774,181	$583,494	$1,033,707	$2,391,382
2020	$839,665	$655,161	$1,123,876	$2,618,702
2022	$891,893	$713,379	$1,195,909	$2,801,181
2024	$894,348	$734,024	$1,162,628	$2,791,000
2026	$755,129	$645,624	$1,006,548	$2,407,301
2028	$506,250	$433,156	$684,122	$1,623,528
2030	$290,968	$241,448	$393,201	$925,617
2032	$104,343	$81,350	$141,005	$326,698
Total	$46,082,071	$21,166,741	$55,585,609	$122,834,421

SUMMARY

- NO DECREASE IN TAX REVENUES FROM PRESENT OR FUTURE PRODUCTION ON EXISTING WELLS

- TAX INCENTIVES APPLY ONLY TO NEW OR ENHANCED PRODUCTION FROM NEW CAPITAL INVESTMENT AFTER DECEMBER 31, 1993 AND BEFORE JANUARY 1, 2002

- APPROXIMATELY 138 NEW WELLS WITH OVER $140 MILLION IN CAPITAL INVESTMENT

- NEW STATE AND LOCAL TAX REVENUES IN EXCESS OF $122 MILLION OVER LIFE OF NEW WELLS

12-10-93
SB 18

- **INCREASE "TAX HOLIDAY" ON HORIZONTAL WELLS FROM 12 TO 18 MONTHS**

- **REDUCTION IN TAX RATES FOR NEW AND ENHANCED SECONDARY RECOVERY**

- **REDUCTION IN TAX RATES FOR NEW AND ENHANCED TERTIARY PRODUCTION**

12-10-93
SB 18

Meridian Oil Inc.

Presentation to the Montana Legislature

1993 Special Legislative Session

Meridian Oil Inc. is one of Montana's most active oil and gas developers and is anxious to increase its level of activity in this state. These materials are presented to encourage additional assistance from Montana to make several Montana projects economically viable.

There are two areas of particular interest. First, we want to discuss the technology and risks associated with horizontal drilling, a technology in which Meridian has been (and continues to be) an industry leader. Hopefully, you may better understand then why Meridian believes that an extension of the "tax holiday" for new horizontal wells is justified. Second, we want to share with you some of our plans for new drilling activity in Montana that we anticipate will occur if the Legislature passes the incentives for new and enhanced oil production.

Meridian believes that these incentives will encourage capital spending, will increase production and will increase revenues for the state of Montana.

Meridian is an active Montana producer and we are currently the largest independent oil and gas company in the United States in terms of total domestic proven reserves (of 6 Trillion Cubic Feet Equivalent - TCFE).

Given an acceptable economic climate, we estimate that Meridian and Shell could spend a combined $140 MM in Montana during the next 5 years. Estimated revenues to the state of $123 MM would be generated from increased production volumes. Furthermore, the proposed incentives would not impact current revenues, only new or enhanced production.

MERIDIAN OIL
DENVER REGION

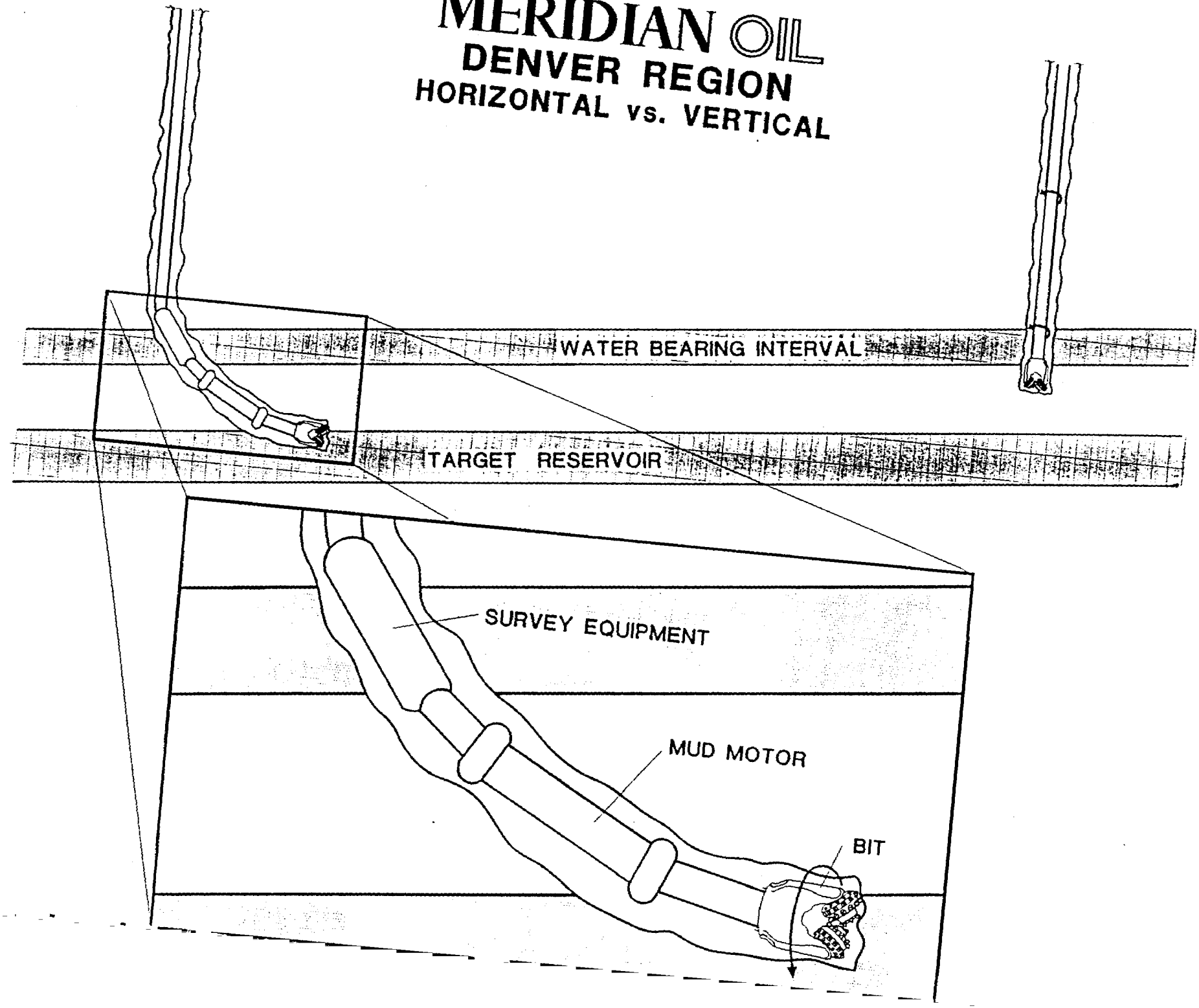
By way of background, exhibit 1 shows that the Denver Region covers a large geographic area from Indiana to the West Coast. However, our historical focus has been in the Rocky Mountain area. Four states, North Dakota, Wyoming, Montana and Colorado account for 93% of our 15,500 barrels of oil and 28 million cubic feet of gas production per day. Additionally, over $41 MM or 95% of our 1993 capital program will be employed in these states.

Our Production offices responsible for the operation of our Montana and North Dakota properties are located (as shown) in Sidney, Montana and Belfield, North Dakota. Upon completion of our 1993 drilling program, we will have drilled 34 new wells in the Sidney-Belfield area. Seven of these are located in Montana. 27 are located in North Dakota.

Three/fourths of our 1993 Sidney-Belfield wells will be drilled horizontally, with 7 out of the total 25 horizontal wells located in a pilot project in Montana.

We have requested that our Board of Directors approve increased levels of capital throughout the Denver Region for 1994. If approved, this would result in a 50% increase over our current year budget. We have proposed 51 new wells (as compared to the 34 in 1993) in the Sidney-Belfield area. We maintain the ability to reallocate capital within this area, as well as throughout the Denver Region, based on the relative economic success of the wells.

MERIDIAN OIL
DENVER REGION
HORIZONTAL vs. VERTICAL



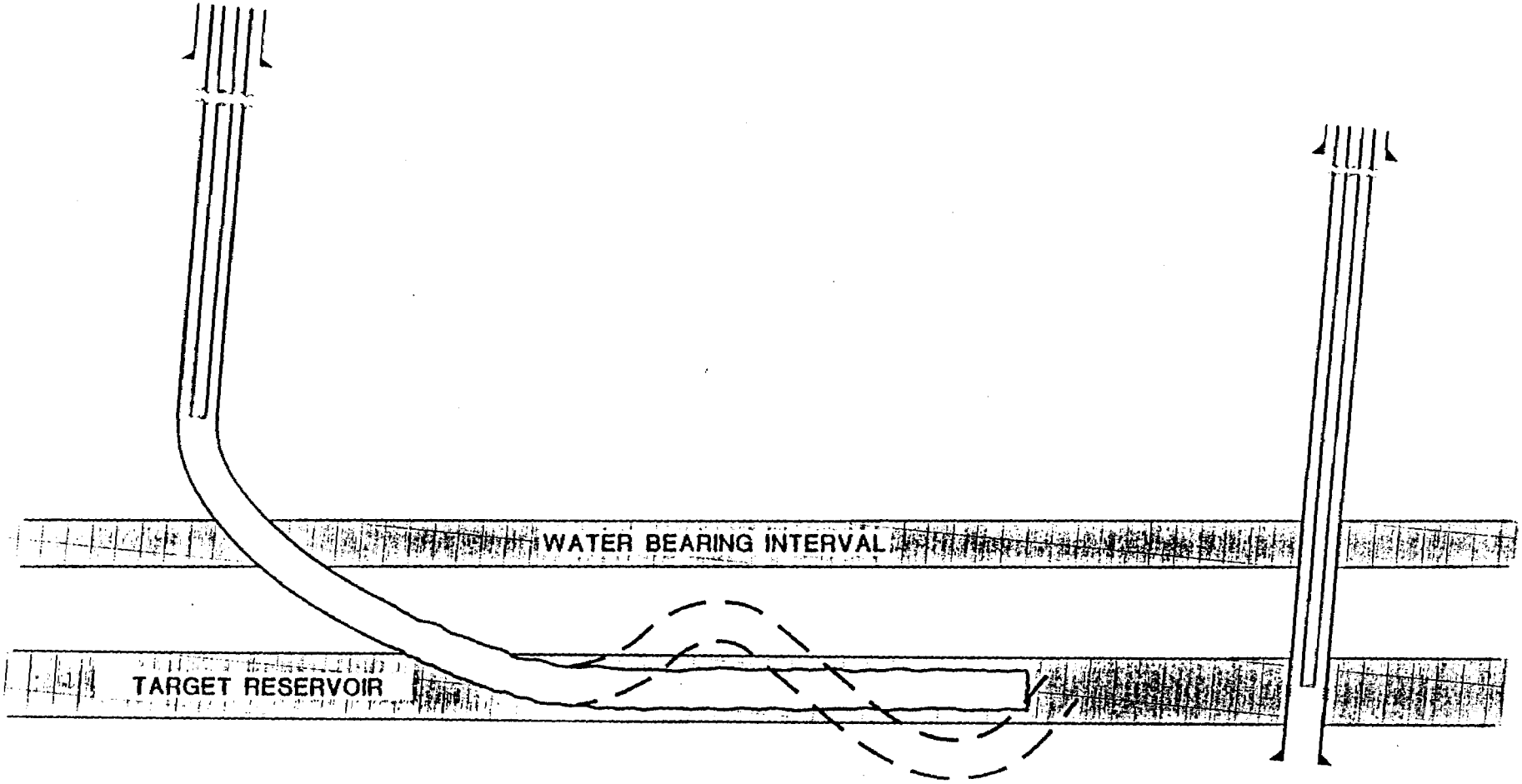
12-10-93
SB 18

I would like to now discuss some of the specifics of horizontal drilling technology and explain why the application of this technology is both more expensive and more risky than traditional vertical well drilling. The second exhibit depicts a horizontal well drilled in an oil or gas reservoir and a well drilled vertically through the same zone.

The exhibit shows that the downhole equipment utilized to drill a vertical well consists of straight steel tools that simply provide the necessary weight for the bit to drill. The entire drill string is rotated from the surface and the bit "naturally" drills vertically.

Drilling horizontally requires that the bit be "steered" into the target reservoir. The process requires downhole tools to continuously survey the location of the bit and the path of the wellbore. The horizontal bottom-hole drilling assembly also contains a bend. A downhole motor, located below this bend, is required to rotate the bit. Although I have greatly simplified the downhole tool description, this basic design allows us to "steer" the bit in the objective reservoir.

MERIDIAN OIL
DENVER REGION
HORIZONTAL vs. VERTICAL



he challenges associated with horizontal projects are great. Reservoirs must be accurately mapped in order to both hit the ›jective formation and to remain in the targeted zone. As diagrammed in Exhibit 3, drilling "in zone" is particularly difficult in thin servoirs of less than 5-10'. Once in the horizontal portion of the wellbore, there remains a higher probability that the costly bottom ›le drilling assemblies will be stuck or even lost in the hole.

an example, I would like to review the problems that we experienced while drilling a horizontal well in 1988 in southeast ›ntana. The downhole tools became stuck while drilling in the horizontal portion of the wellbore. Seven days were lost attempting recover the stuck tools, setting a cement plug and drilling around the lost tools. The total cost of the problem exceeded $350M, ich included $200M for the lost downhole equipment. These costs are significant when you consider that the cost of a problem- e well in this area is approximately $1MM.

en-hole logging procedures are more complicated since the wireline conveyed tools will not gravity fall to the end of a horizontal llbore. These technical challenges are not unique to the drilling operations. Difficulties are frequently encountered during the npletion and production phase of the horizontal projects. Problems are commonly associated with running and cementing duction casing, perforating the casing, stimulating the reservoir and (like in the open hole case) conducting logging operations.

EXHIBIT 2
12-10-93
SB 18

Industry reports of the increased time and cost of these procedures vary widely. Costs of 2-3 times that of offset vertical wells have been reported. We have been drilling horizontal wells in the Meridian Denver Region since 1987. Our experience has demonstrated that drilling wells horizontally as opposed to vertically results in:

50% to 100% increase in our daily drilling cost

50% to 100% additional drilling time - and -

25% to 50% of additional footage drilled in the horizontal portion of the wellbore.

In spite of these higher costs, the industry has attempted horizontal wells worldwide in a variety of oil and gas reservoirs. The economic viability of the projects has also varied significantly. A number of horizontal attempts have been economic failures.

thin Meridian, horizontal projects have experienced mixed economic results. As of August of this year, Meridian has drilled 218 izontal wells. The wells were drilled in 22 pilot project areas, testing different geologic formations that produce both oil and ural gas.

otal, we consider the effort to be economically successful and we are quite pleased with our overall horizontal program. We can ionstrate this by pointing out that over 80% of these 218 horizontal wells have been drilled in the development of successful pilot grams. However, all these development wells were drilled in just 3 of the total 22 horizontal programs that have advanced ond the pilot phase. The remaining 19 pilot projects, including our proposed Montana projects, are still in the evaluation stage have not proven economically attractive enough to merit further development.

eel that the mixed success rates reported by industry and these results within Meridian, demonstrate the marginal economic re of most attempts at horizontal drilling. Therefore, any incentives to drill these risky and costly horizontal wells would be well ved by the industry.

EXHIBIT 2
12-10-93
SB 18

I would now like to discuss our proposed Montana drilling program to demonstrate both the risk and extent of what we are currently considering. I will focus on our East Lookout Butte horizontal pilot in southeast Montana. The project is near the Shell operated Pennel Unit on the east flank of the Cedar Creek anticline, as shown on Exhibit 4.

The project was initiated in 1988 when Meridian drilled 5 horizontal wells, attempting to achieve higher producing rates than the low rates of the existing vertical wells in the area. Even though higher rates were achieved, the wells were still marginally economic due the increased cost of the horizontal wells. In the same year, Meridian initiated a one year pilot water flood by injecting brine water into a single vertical well. We then requested and were granted extensions of the pilot water flood by the Board of Oil and Gas Conservation in 1989, 1990 and 1992. This project had been in a producing and evaluation phase then for 4 years until the beginning of 1993. This year, we expanded this pilot project by drilling 7 new horizontal wells.

We were able to justify these new wells primarily because of cost savings and efficiencies that we had gained from horizontal experience throughout our company during that 4 year period. The economic results of these 7 wells will impact our decision to move forward with the full project development of 70 wells in the East Lookout Butte project over the next 5 years. Due to current depressed oil price of less than $15/bbl in the area, these wells also appear marginally economic in spite of lower drilling costs than the 1988 program.

The results of the horizontal drilling attempts industry-wide, throughout Meridian and in our East Lookout Butte project, all demonstrate the marginal economic nature of horizontal wells.

Factors that effect the economics of horizontal projects are oil price, drilling and production costs, production rate and others such as the taxes that we are discussing today. Most of these variables are beyond our control. The proposed incentives, however, are variables that the state can influence.

mplementing the proposed horizontal drilling and enhanced oil recovery incentives would positively impact the East Lookout Butte ilot program, as well as the other Montana projects that Meridian has under consideration for 1994 and succeeding years. The conomics of horizontal wells drilled in the area would be improved to the point that the project would compete favorably for capital ith other projects within the Denver Region and throughout Meridian.

rovided that we are able to economically justify moving forward on this and other similar projects, we estimate that Meridian could ill up to 107 wells in the State of Montana over the next 5 years at a capital cost in excess of $113 MM. With an average of 44 rect employees per drilling operation and with at least 2 drilling rigs operating full time for the next five years, we believe that the illing activity alone will substantially add to the Montana economy. We estimate that annual salaries of approximately $3.4 MM er year would be paid to approximately 88 employees directly supporting the 2 drilling operations.

EXHIBIT 2
12-10-93
SB 18

I encourage you to strongly consider the proposed incentives for horizontal drilling and enhanced oil recovery projects. I believe that the incentives will serve to induce new, significant capital spending in Montana and will ultimately result in increased production and increased revenues for the state.

I appreciate the opportunity to discuss these issues with you and I welcome any questions that you may have for me today.

EXHIBIT
DATE 1/21
SB 18

BRIEF COMMENTS AND STATISTICS SUPPORTING SENATE BILL 18

1. What are the tax incentives contained in Senate Bill 18?

(a) New vertical wells now receive a 12-month holiday from payment of the Net Proceeds Tax. This bill extends that tax holiday to 18 months for new horizontal wells. Vertical wells would continue to receive the 12-month holiday. The extension of this holiday recognizes the substantial increased costs of drilling for horizontal wells.

(b) For secondary recovery projects--a reduction in the Local Government Severance Tax or the Net Proceeds Tax, whichever applies, from 8.4% or 7%, respectively, to 5% on the incremental increase in production from new or expanded secondary recovery projects. The state severance tax would be decreased from 5% to 3% on this same type of production.

(c) For tertiary recovery projects--a reduction in the Local Governments Severance Tax or the Net Proceeds Tax, whichever applies, from 5.0% or 7.0%, respectively, to 3.30% on the incremental increase in production from new or expanded tertiary recovery projects. The State Severance Tax would be decreased from 2.5% to 2.0% on this same type of production.

2. Are the tax rates on existing production decreased?

No. This bill has no effect whatsoever on present or future revenue flow from oil and gas now being produced. Regular tax rates will continue to be assessed and paid on the normal rate of future production on oil now being produced.

3. Is there a "sunset" for the reduced tax rates established in Senate Bill 18?

Yes. The tax incentives contained in Senate Bill 18 will only be applicable on new horizontal wells or on new incremental production from secondary or tertiary recovery projects which are commenced between December 31, 1993, and January 1, 2002. After January 1, 2002, the tax incentives would not be effective and applicable on projects commenced or wells started after that date.

4. Is there any price "cap" on the price of oil which, if reached, would terminate the applicability of the incentive tax rates?

Yes. If the price of benchmark West Texas crude oil should average $30.00 or more per barrel for any calendar quarter, the incentive tax rates would not be applicable. If the price of such oil should average less than $30.00 per barrel for any subsequent calendar quarter, the incentive tax rates would again be applicable.

5. **Will the incentive tax rates result in the collection of more and new tax revenues?**

Yes. Meridian Oil, Inc. and Shell Western E & P, Inc. estimate that the increased production realized from the projects they contemplate commencing will result in the collection of a total $122,834,421 in increased state and local taxes, as well as royalties received by the state from production on state lands over the 30-year period of the expected life of production from the projects.

Specifically, the figures are:

State taxes --	$ 46,082,071
Local taxes --	$ 55,585,609
Royalties --	$ 21,166,741
Total --	$122,834,421

6. **How many wells do Meridian and Shell believe they will drill if Senate Bill 18 is approved?**

Approximately 138 over a five-year period.

7. **What will be the cost of the proposed development program?**

Approximately $141,350,000 over a five-year period.

8. **Is oil production declining in Montana?**

Yes. It is declining at the approximate rate of 7% per year. This decline will continue unless something is done to generate new production.

Oil production in Montana peaked at approximately 48 million barrels during the year 1968. It has declined to approximately 18 million barrels in 1992.

There has been a commensurate reduction in tax and royalty revenues received by state and local governments during that time.

9. **What is the total cumulative effect of the tax reductions contained in Senate Bill 18 on new incremental production and/or new horizontal wells?**

The tax rates on new incremental production from secondary or tertiary recovery projects are decreased from present levels by approximately 28%. This only applies to new incremental production. The tax rates on new production received from horizontal wells engaged in primary production only would continue to be those rates now charged after the 18-month holiday from payment of the Net Proceeds Tax has expired.

10. If these incentives are adopted, how will they compare with what is available form North Dakota and Wyoming?

Using current effective rates of tax on Meridian Oil operated leases in North Dakota and Wyoming, our tax department has determined that the adoption of these incentives will result in effective rates of tax in Montana approximately 1.8% higher than North Dakota and 3.96% lower than Wyoming for secondary recovery. For tertiary projects, the tax rate in montana would be approximately 1% higher than North Dakota and 5.61% lower than Wyoming. For primary production from horizontal wells, the proposed effective tax rate in Montana would be approximately .9% higher than North Dakota and 1.16% lower than Wyoming.

Our analysis leads us to conclude that the adoption of the proposed incentives will result in tax treatment of these types of production in Montana being very competitive with comparable tax treatment in North Dakota and Texas and represents a significant advantage over that imposed in Wyoming.

11. Why should this legislation be addressed now? Why can't it wait until the 1995 regular session of the legislature?

Shell Western E & P, Inc. must promptly make decisions regarding the future of its Cedar Creek Anticline operations in eastern Montana. The field was started in 1951. Shell commenced water flood secondary recovery operations about 30 years ago. About 30% of the oil in place has been produced. Much of the infrastructure in the field is aging. Shell must promptly repair and replace that infrastructure and in so doing must expand the enhanced recovery operations to endeavor to produce as much of the remaining oil as possible. Decisions on the future of these operations must be made now if maximum recovery of the remaining oil in place is to be attained. Shell cannot wait for 1½ or 2 or 2½ years to make these decisions. The project is economically marginal at best, and thus the tax incentives will play a large part in the decisions which Shell will make in early 1994 regarding the future of the Anticline operations.

In Meridian's case, that company has been conducting pilot drilling operations in eastern Montana for a number of years. Results have been encouraging but not spectacular. However, there are many positive indications that lead Meridian to believe that a substantial horizontal drilling program could be relatively successful, but the drilling projects are economically marginal. Meridian has some capital available at this time for investment. The Montana projects must be considered against projects in other states that have more positive economic indications. The tax incentives would allow the Montana projects to rank economically with or slightly above the others. While Meridian's investment capital has been allocated for 1994, funding may not again be available for Montana projects for some years into the future. Thus, Meridian must make decisions on the Montana drilling program promptly.

Both companies intend that operations would start in early 1994.

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SB 18

12. What are the positive aspects of Senate Bill 18?

Passage of Senate Bill 18 would:

(1) provide new revenues in future years, even beyond this biennium, without the institution of a tax increase;
(2) would inject new investment into the state to stimulate economic development; and
(3) would do so without jeopardizing current and future revenues from existing production.

PREPARED AND CIRCULATED BY

Jerome Anderson
Representing
Shell Western E & P Inc.

Stanley T. Kaleczyc
Representing
Meridian Oil Inc.

EXHIBIT_____
DATE 1/21/19
SB 18

TESTIMONY OF R. E. SHEFFIELD

SHELL WESTERN E&P INC., HOUSTON, TX

IN SUPPORT OF LEGISLATION TO ENCOURAGE

HORIZONTAL DRILLING AND ENHANCED OIL PRODUCTION

My name is Bob Sheffield. I am Western Asset Technical Manager for Shell Western E & P Inc., based in Houston, Texas. SWEPI, as we are sometimes #1 called, explores for and produces oil and gas in the US. We have operations stretching from Florida to Alaska. My territory in the Western Asset stretches from West Texas and New Mexico up the Rockies to Montana and on into Alaska. In my position I am responsible for technical review of all new projects and preparation of our capital budgets.

Shell is the largest oil producer in Montana, accounting for about 30 #2 percent of the 20 million barrels produced here every year. We first discovered oil in Montana in 1951 near Glendive. This is in what's known as the Cedar Creek Anticline, a prolific formation running nearly 100 miles from Glendive through Baker and across the state line down into North Dakota. At the height of our development, in the late 50s and early 60s, there were times that we had as many as 16 drilling rigs operating in our field in Eastern Montana. We had major offices in #3 Billings and Glendive and five field offices. Production peaked in 1964 at 39,000 barrels of oil per day. At this time we had about 60 Shell employees in Montana and also employed several hundred contract service personnel. Although our oil production has been gradually declining, we

have been working hard to reduce this decline and prolong the productive life of the field.

Currently we produce more than 16,000 barrels of oil a day from 460 wells. We operate nearly 200 water injection wells, three gas conditioning facilities and 50 field locations with a total investment of $350 million. We now have about 50 employees in Montana and pay $14 million a year in taxes. These tax payments have been steadily declining as our oil production has declined.

#4

Although we pay a variety of taxes on our oil production, they basically work the same way. You take the tax rate and multiply it times our production volume and the price of crude oil. The combined Montana tax rate of about 12.7 percent is the highest oil & gas tax rate of any state that we operate in. The taxes we pay to Montana have been falling because both our production volume and crude prices have been falling.

#5

I would like to briefly discuss some basics of oil production, especially defining the waterfloods that we use extensively now in the Cedar Creek Anticline. The first phase of production is what we call Primary Production where we produce the oil with pumping units simply relying on the natural pressures of the formation. This continued for about 10 years in our field and we were able to recover 15-20 percent of the oil originally inplace. Production would have declined rapidly and we would have sold or abandoned the field by now if we had not taken action to supplement natural reservoir pressures.

#6 The action we took to stop the production decline was implementing Secondary Production, which in the case of this field is a waterflood. As the name implies, in this method we pump water back into the producing part of the field -- usually brine or salty water that is produced with the oil or from deep brackish formations. The water is pumped into the oil producing formation to help maintain the original pressure that drives the oil through the rocks to the producing wells.

It is very difficult to produce all of the oil in your existing formations. We have now been on Secondary Production for 30 years and have produced approximately 30 percent of the oil originally in place. We have invested $100 million in waterflood equipment, including pumps, flowlines, water handling and storage tanks, and a great deal of electrical equipment to keep it all working. Our electricity bill alone is about $400,000 a month! The added cost of a waterflood has to be justified by the added production you can get.

#7 The third step in recovering additional oil is Tertiary Production. This is a much tougher economic decision. The oil left behind by the waterflood is the hardest to produce. In the mid '80s, we considered injecting CO2 into our formation. We actively lobbied this Legislature for tax incentives to make this economically feasible. We said at the time that the economic feasibility for this proposed project was based upon crude prices of $27 per barrel. The project was not carried out because shortly after the tax incentive was passed by the Legislature, #8 oil prices plummeted drastically, to nearly $10 per barrel, making it economically impossible to carry out the project. CO2 is one of the most

widely used Tertiary Production techniques. Others include chemicals such as polymers and surfactants and even steam. In most cases, this third phase is significantly more expensive. At the current average price of $12.50 a barrel for Montana oil, it is very difficult to justify the investment required. However, there are some operators who are considering tertiary projects right now.

#9

The oil industry has changed dramatically in the 40 years that Shell has been in Montana. During this time, the combination of the US government restricting exploration in many prime areas and this cost/price squeeze has forced many large US oil companies to look elsewhere for new opportunities. Many have taken their exploration efforts overseas. Those of us who remain dedicated to the US have had to work smarter. Yes, like many industries, we have had to trim costs, including laying off employees. My company has cut back over 20 percent in the last few years.

We have also invested heavily in new technology. First, most of our existing wells are all monitored electronically, so that we know exactly how each well is doing from a computer screen in the office. Next, we have taken the newest exploration tool -- three dimensional or 3D seismic -- and have used it extensively throughout the Cedar Creek Anticline. Much of this work was done in the late 80s. Now, we have interpreted that seismic and are attempting to further develop the area. For the past few years we have been drilling north of Baker in the Pine, Pennel and Cabin Creek areas.

#10

#11 As we move southeast in the Pennel Unit, the rock quality tends to deteriorate, making oil production more difficult. This picture shows well density in our Pennel Unit. You can see more wells in the north and more open spaces in the south. As the rocks thin out in the south and east, we cannot justify the cost of the many traditional vertical wells it would take to produce this. So we have experimented with horizontal wells that, while much more expensive, could economically recover the oil #12 in this poorer part of the field. To date, our tests have been encouraging.

Let me show you a simplified chart of our Cedar Creek Anticline and how it responds to the kind of expanded water flood we are discussing. This #13 curve represents a normal production cycle, with production gradually falling off as years go by. The Cedar Creek Anticline is 40 years old and we are well into the later stages of production. The tax incentives we are proposing are to make expansion economically feasible. By drilling additional horizontal wells we plan to expand production and extend to life of this field. Without this additional investment, we expect this field to become uneconomic soon after the turn of the century. With this additional phase of investment, we think we can add another seven years to the field's life. Please note that the normal expected production, shown in blue, will be taxed at the current rates. It is only the incremental - or added production - shown here in red, that is taxed at the lower rates we are suggesting.

We are now prepared to move forward with a $25-30 million program of at least a dozen horizontal wells and perhaps 20 traditional vertical wells.

over the next several years. If these are economically successful, we would probably find other locations in our field to drill horizontal wells in a second phase of this effort. We hope this first phase will add nearly 4,000 barrels of oil to our current daily production of 16,000 barrels and 11 million barrels to the ultimate recovery of this field. Over the next 15-20 years we estimate that this investment will generate $13-15 million in additional tax revenues to the state and local communities. That's new revenues above and beyond the taxes we pay on our current production. What's more, the tax incentives will help us extend the life of the field, which helps extend the jobs this field generates -- jobs for Shell employees and many others in the community.

We are currently evaluating the results from our second horizontal well, the total costs involved and the relative earning power of these wells as compared with other possible investment opportunities in other parts of my territory. When we first start in the budgeting process, there are always several "sure things" that are easy to approve. Then, as you review other projects you reach a group of investments that are closely competitive and "marginal" in a sense that they all just meet our investment criteria. These Montana wells are like that. They are sitting on an economic bubble, or the outer limits of our 1994 budget. By that I mean they are generally the most marginal of the many new projects that we are considering. However, when you factor in the new, lower taxes we are discussing, these projects improve their rate of return and "beat out" the other "marginal" projects.

#14

So I am here today proposing that the State of Montana consider economic incentives for renewed investment in oil development. We have invested the time, technology and money to fully evaluate these prospects. We are asking the State of Montana to offer new, reduced tax rates on new investment only. (Remember, all of our existing production would continue to be taxed at the current higher rates.) In return for these tax incentives, we are prepared to invest heavily in Montana, bring more drilling jobs to the state, increase the life of our oil field and thereby prolong the duration of jobs at our field. Perhaps most importantly to you here, this project will generate additional tax revenues to the state and counties. What's more, it's not just Shell and Meridian, although we are clearly in the forefront and ready to commit large amounts of capital now. We have talked to numerous smaller oil companies who are also evaluating horizontal technology. Several have already drilled a few wells in Montana or are considering it. They are watching us here today. If we move forward together in a positive fashion, I think it is reasonable to expect others to invest in Montana.

I believe this as a solution that benefits everyone. There is no loss of tax revenue to the state, there is only increased revenue. We will invest capital and create jobs.

Some say the State doesn't need to "help" Shell because we will drill these wells anyway, even at the higher tax rates. Yes, we will probably drill some. But, returning to my investment example: At the old, higher tax rates, these Montana wells have strong competition for capital funds from other Shell projects. The lower tax rates give this project a

little breathing room to stay ahead of other projects. In the long run, that means we will be able to drill more wells in Montana, rather than curtailing our expansion before its completion.

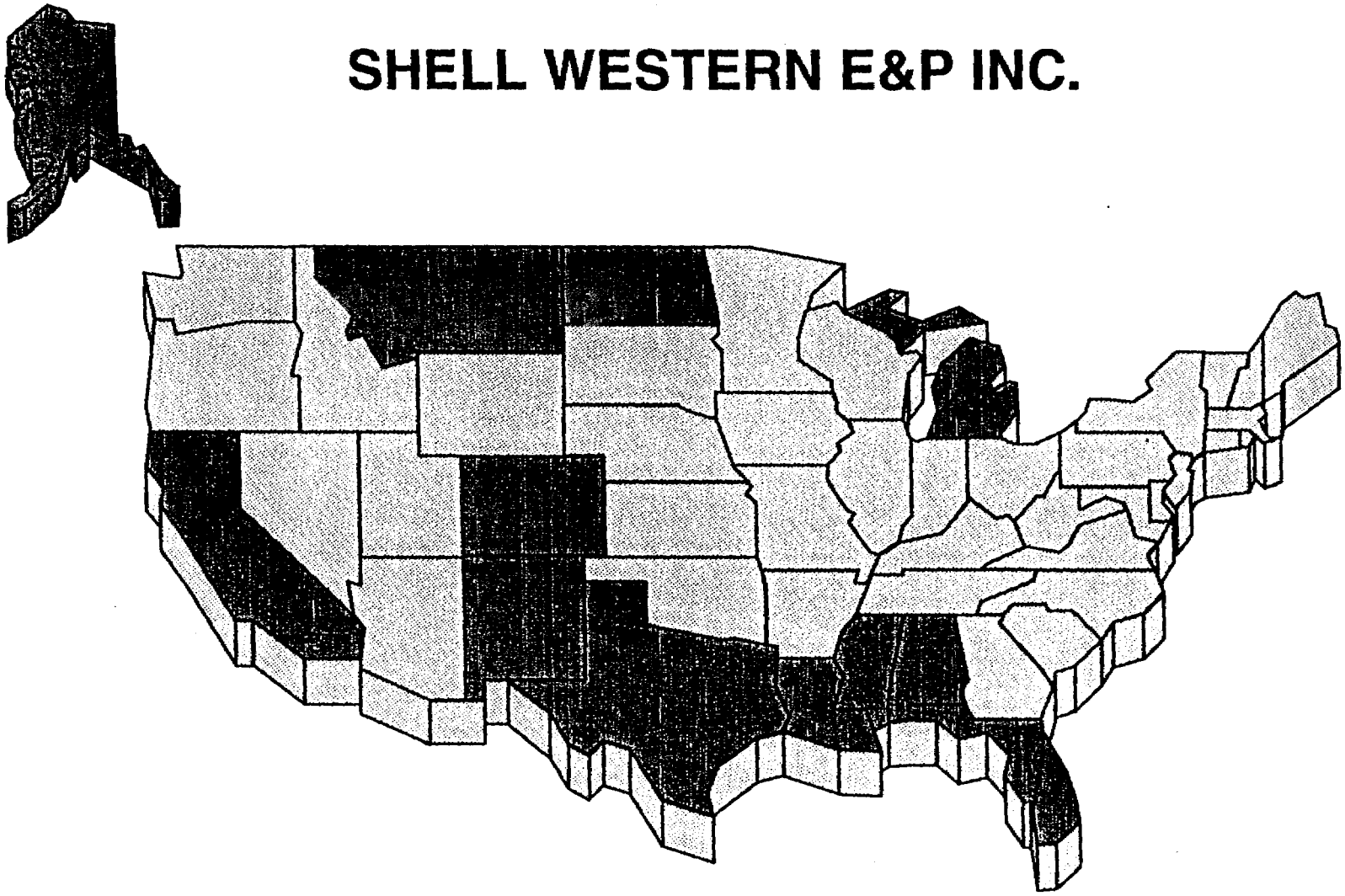
The other question we have been asked repeatedly is "Why now? What's your hurry?" In other words, why can't this wait until the '95 Regular Legislative Session?

It is a necessity that we act now! Both Shell and Meridian have done their homework -- the seismic has been shot, its interpretation has been done, we have drilled a few horizontal wells to test our theory. In Shell's case, we have a mature field in a decline. With an aging field infrastructure and declining oil production, if we do not act now the field won't justify further investment. We are already at the point that many traditional vertical wells don't make economic sense. That is why we must drill the more expensive and riskier horizontal wells. To revive the field we need to act now. My department has the budget authority to move forward on the projects that meet our economic criteria. Before long, we will begin our 1995 planning cycle. If we wait until after your 1995 Regular Legislative Session, we will be working on our 1996 budget. If we delay this project, or only drill part of the first phase, we may lose the financing for the second phase to other areas. With production from the Cedar Creek Anticline otherwise declining rapidly, the economics may never again be favorable for further development with horizontal wells. Thus, if we are to take steps to maximize the production from our Montana holdings and also maximize the tax amounts that the State and local governments could receive, we must be able to act now. I view this

as a unique opportunity, timewise as well as opportunity wise. The time is now and we can move forward together.

Thank you for giving me the opportunity to speak today. I would be happy to address your questions.

SHELL WESTERN E&P INC.



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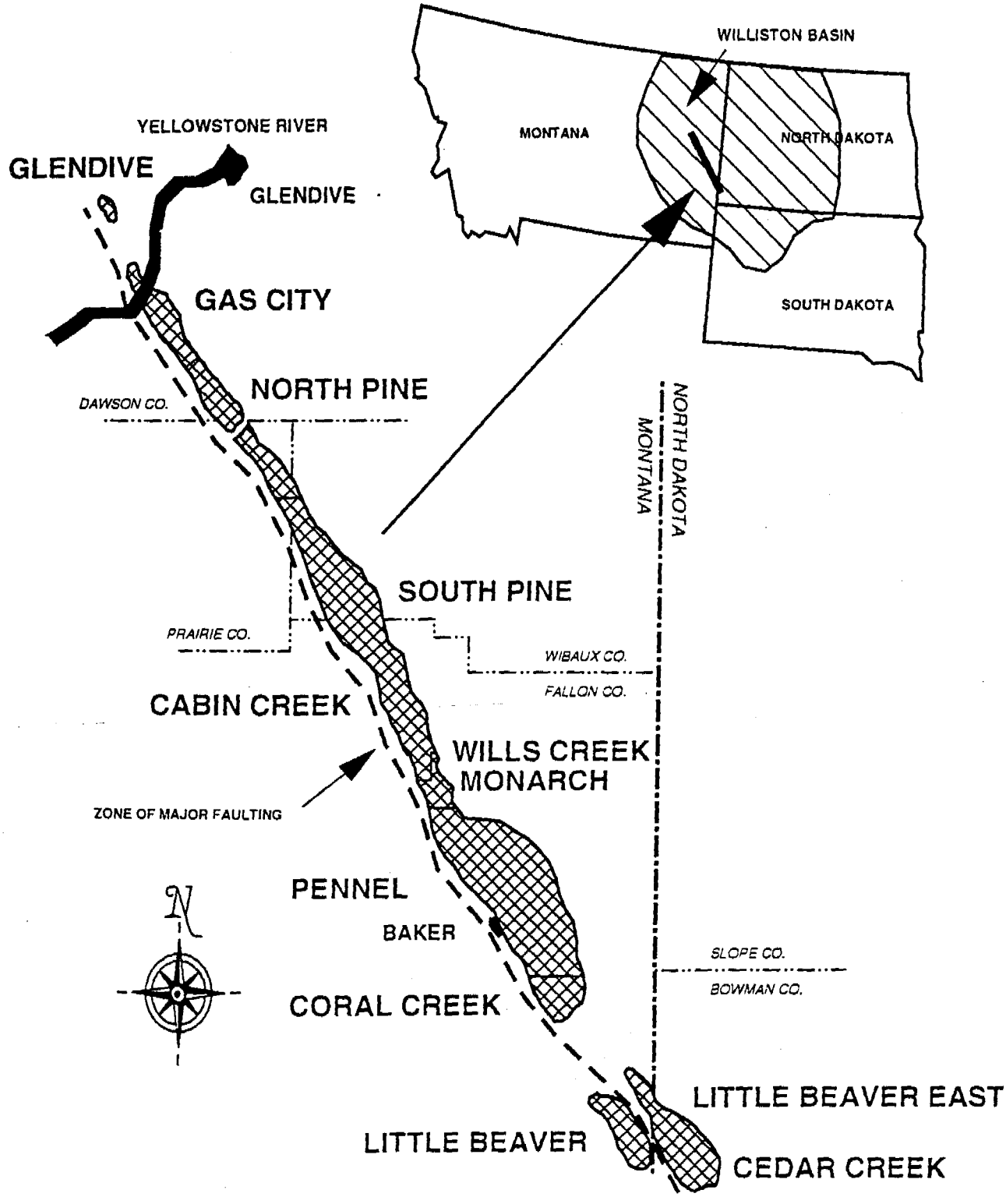
CEDAR CREEK ANTICLINE



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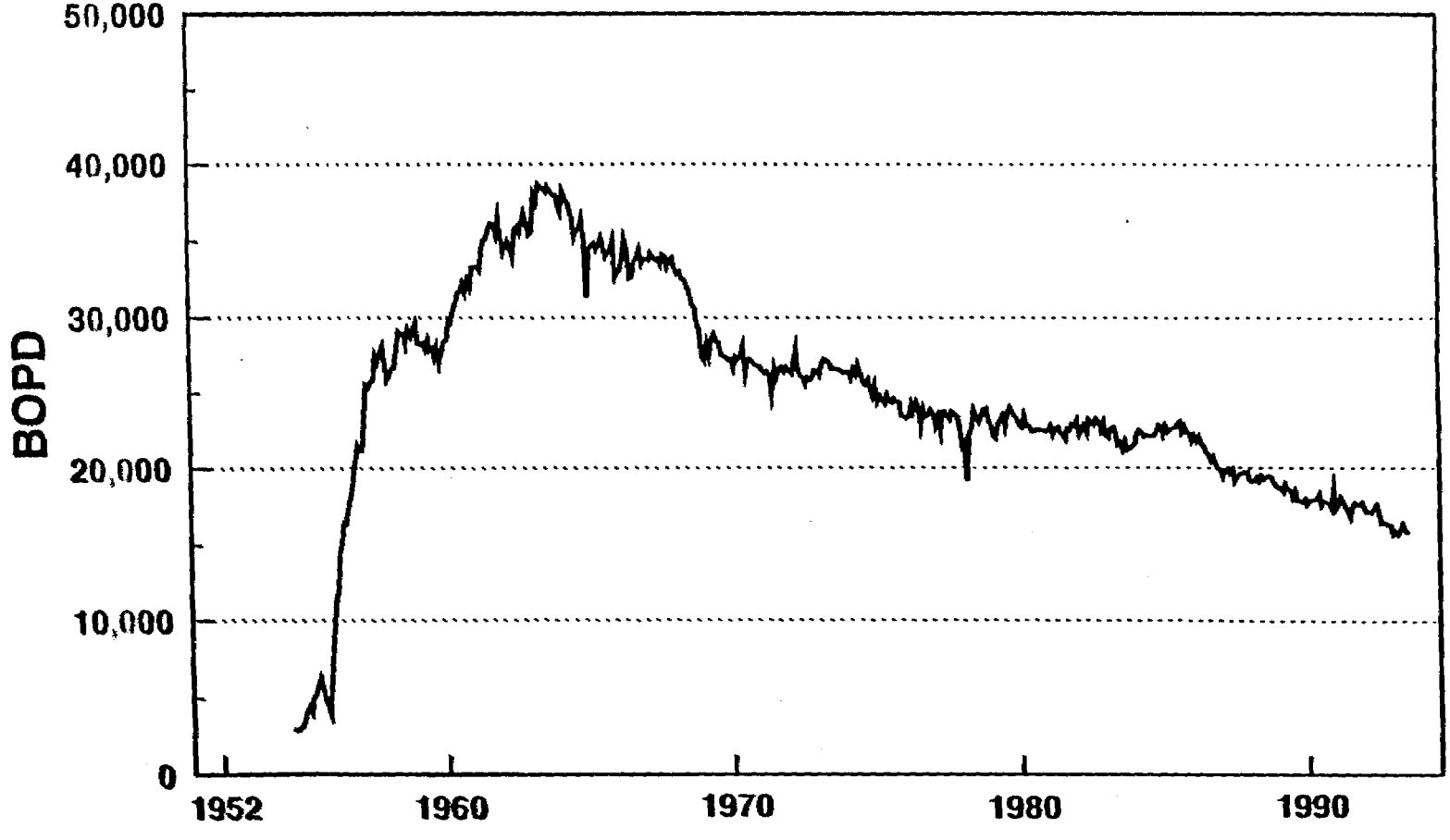
CEDAR CREEK ANTICLINE

OIL PRODUCTION



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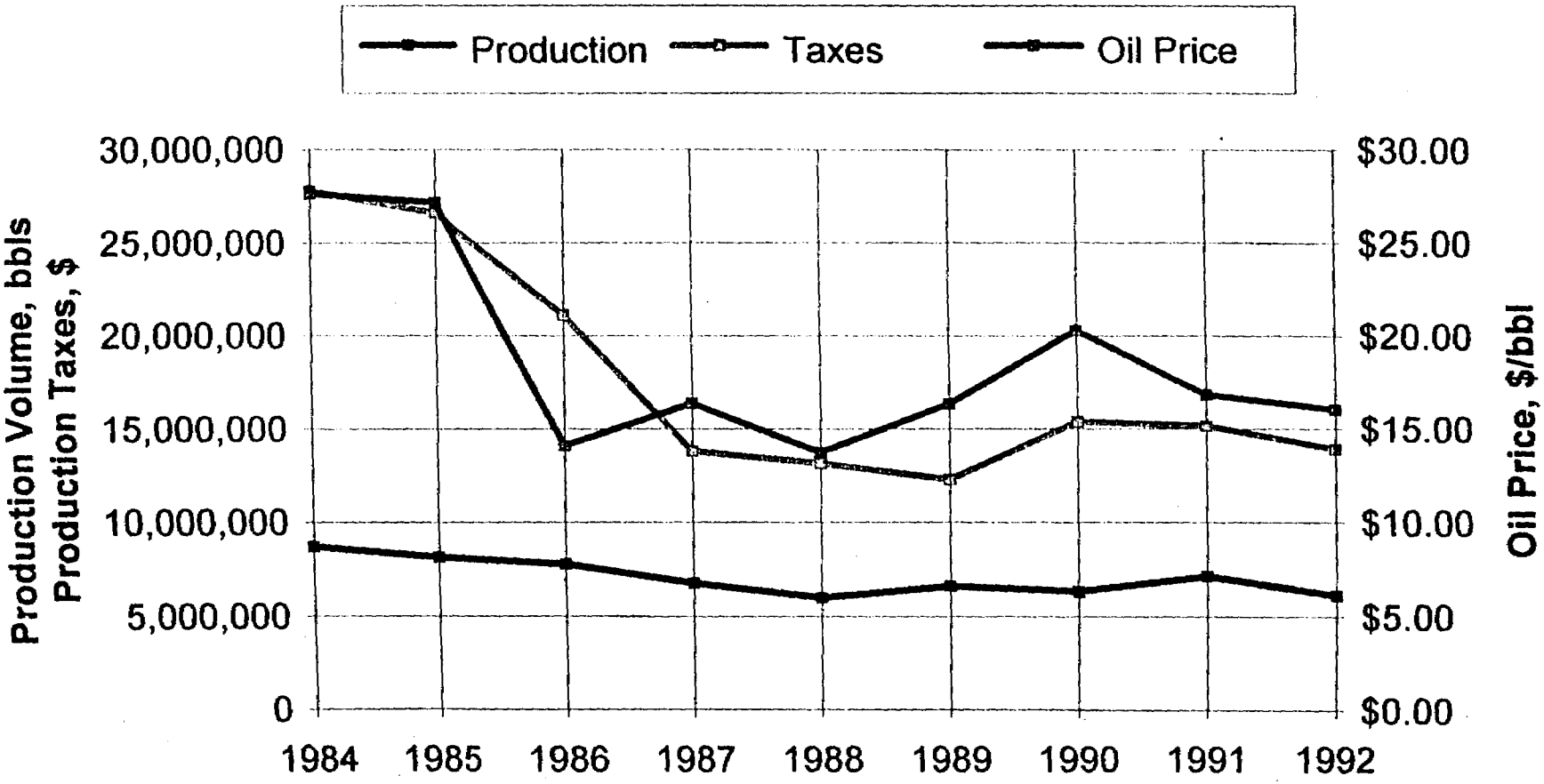
SWEPI's Production Tax Liabilities in Montana



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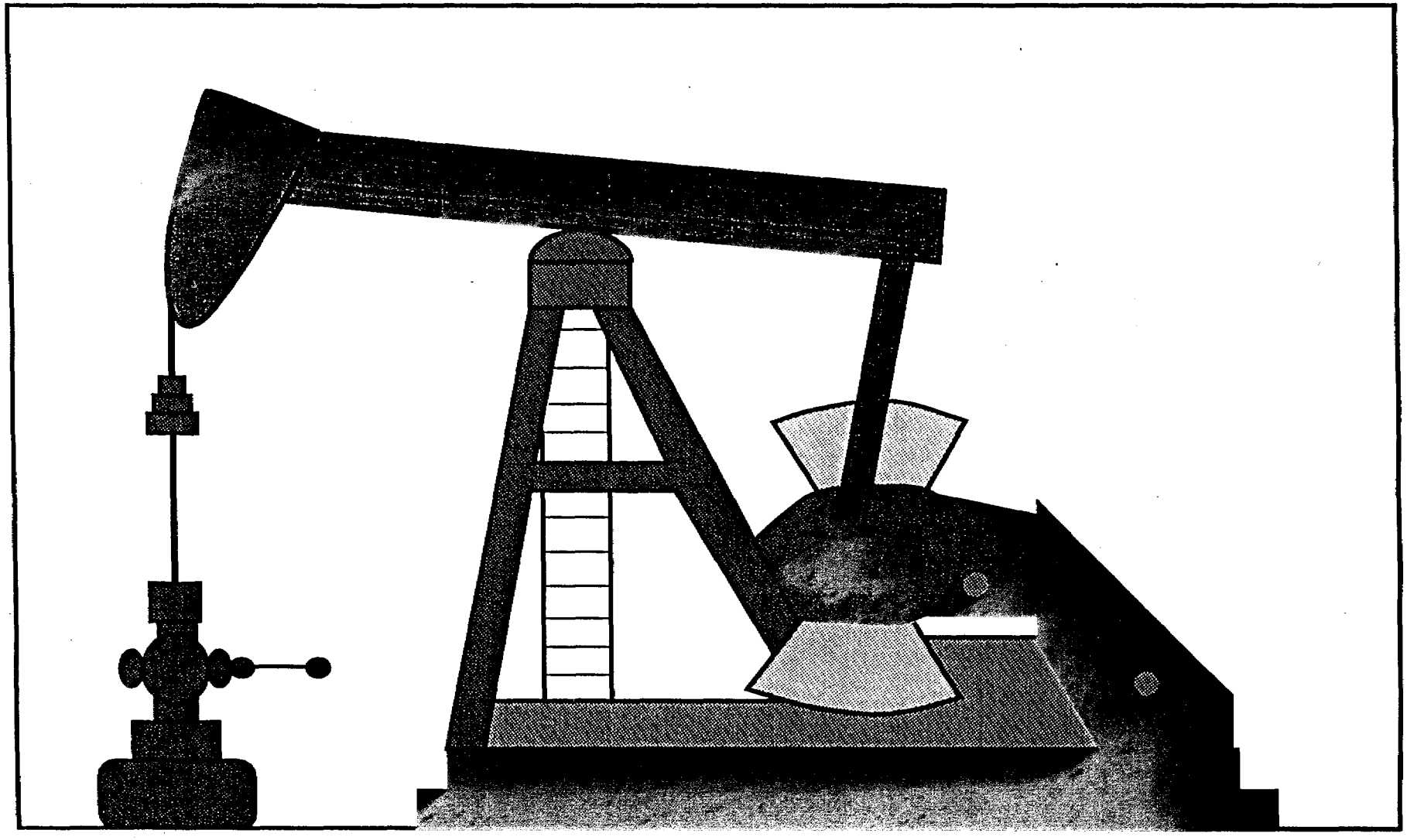
Pumping Unit



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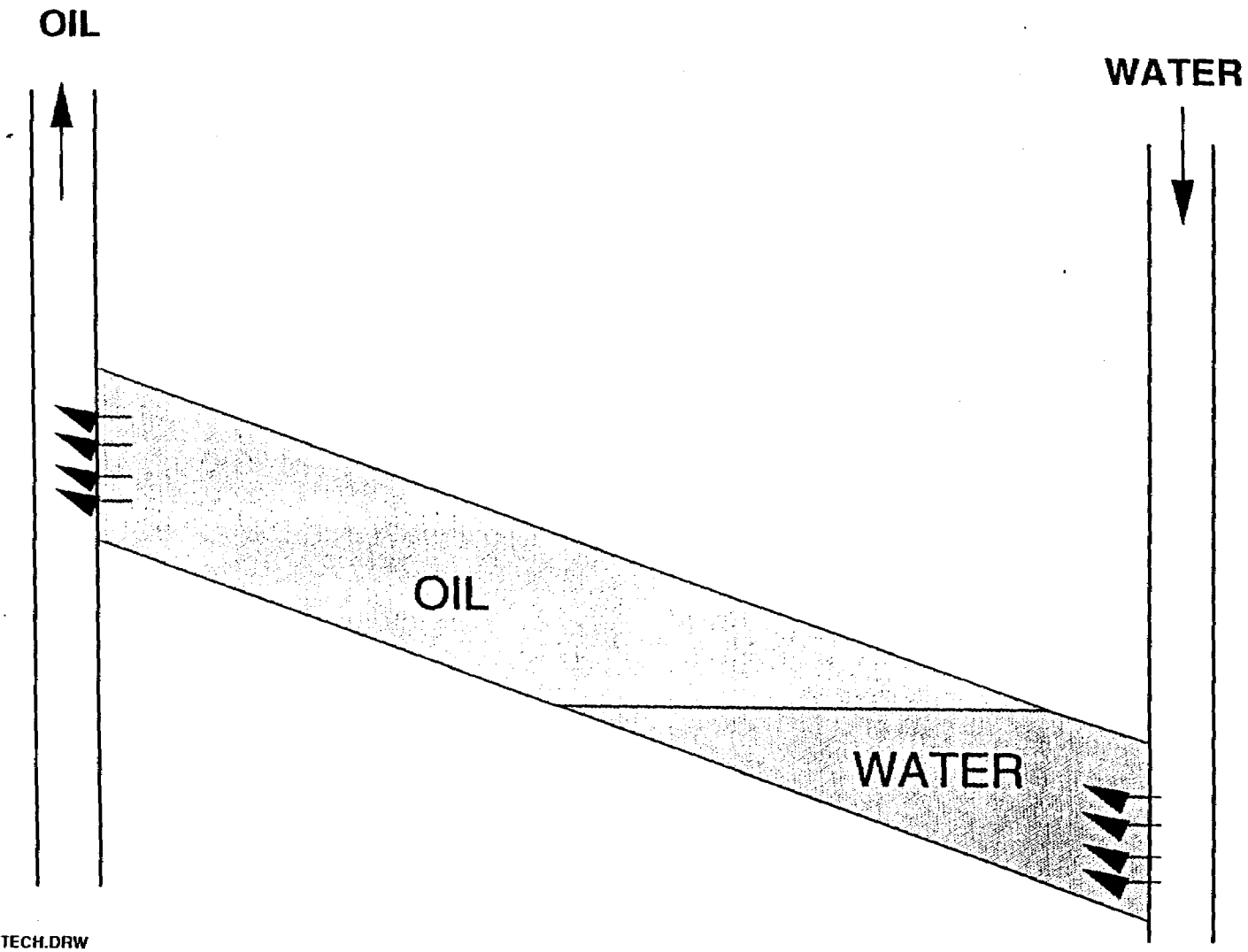
CEDAR CREEK ANTICLINE

WATERFLOODING TECHNIQUE



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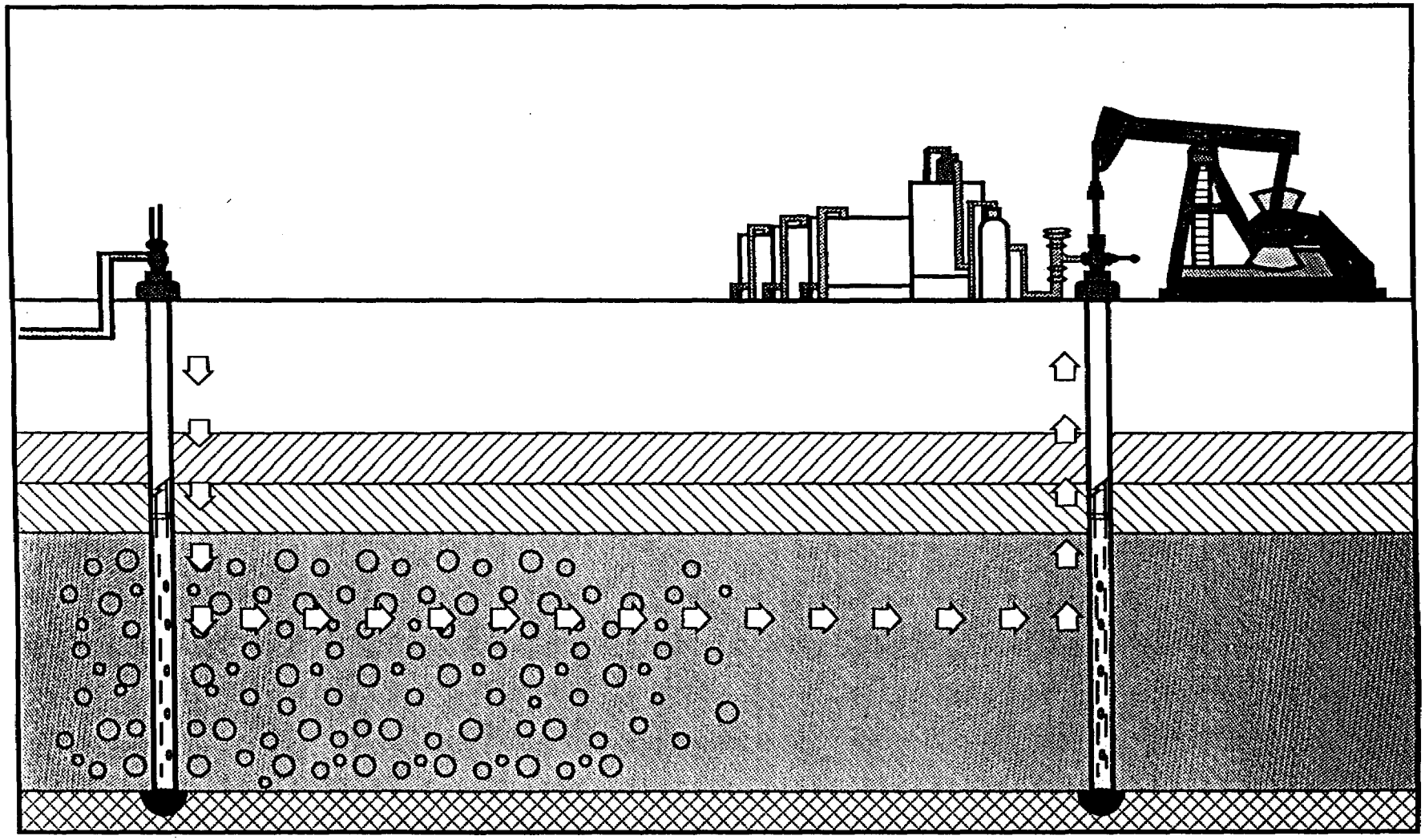
SB 18

Tertiary Production



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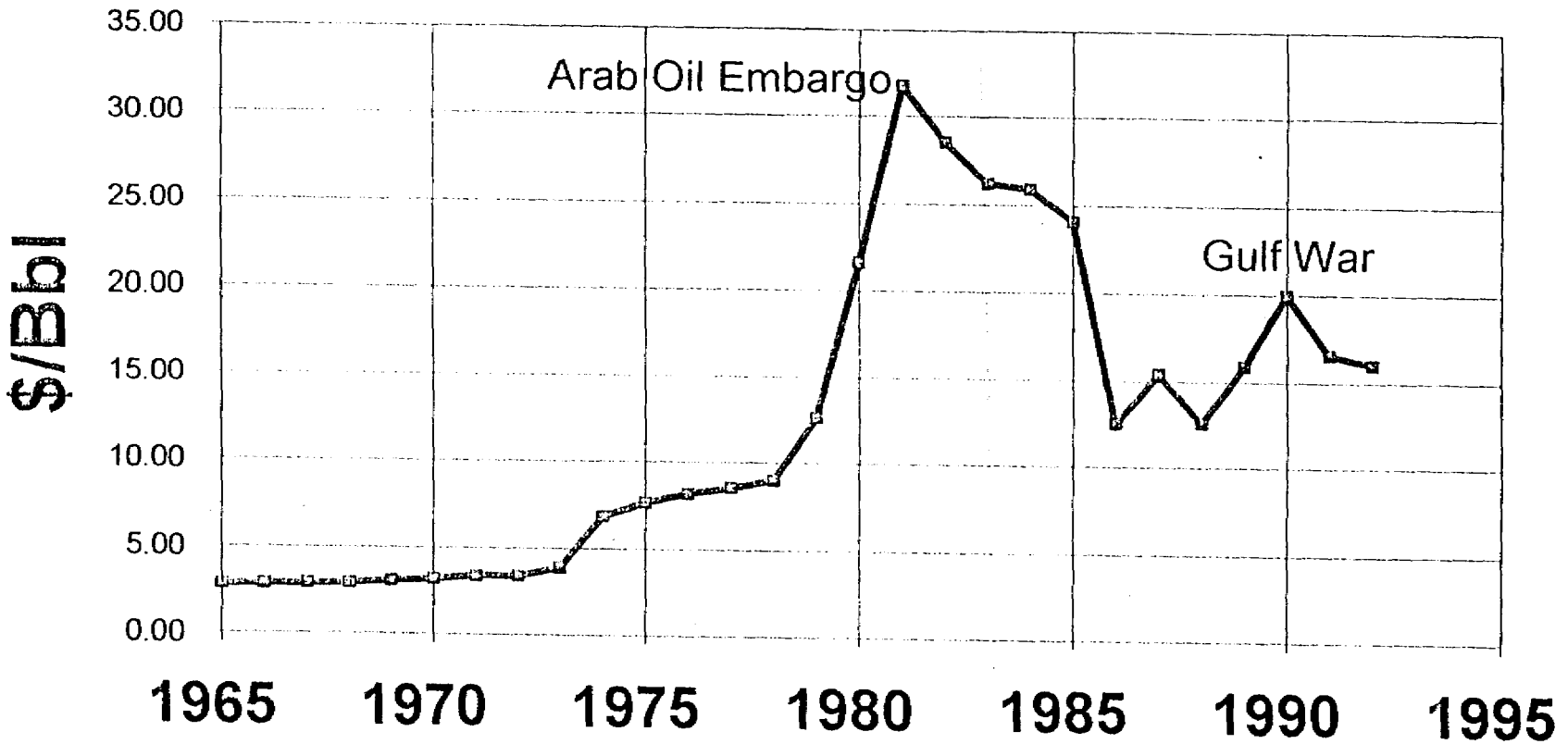
Average Price of U.S. Crude Oil



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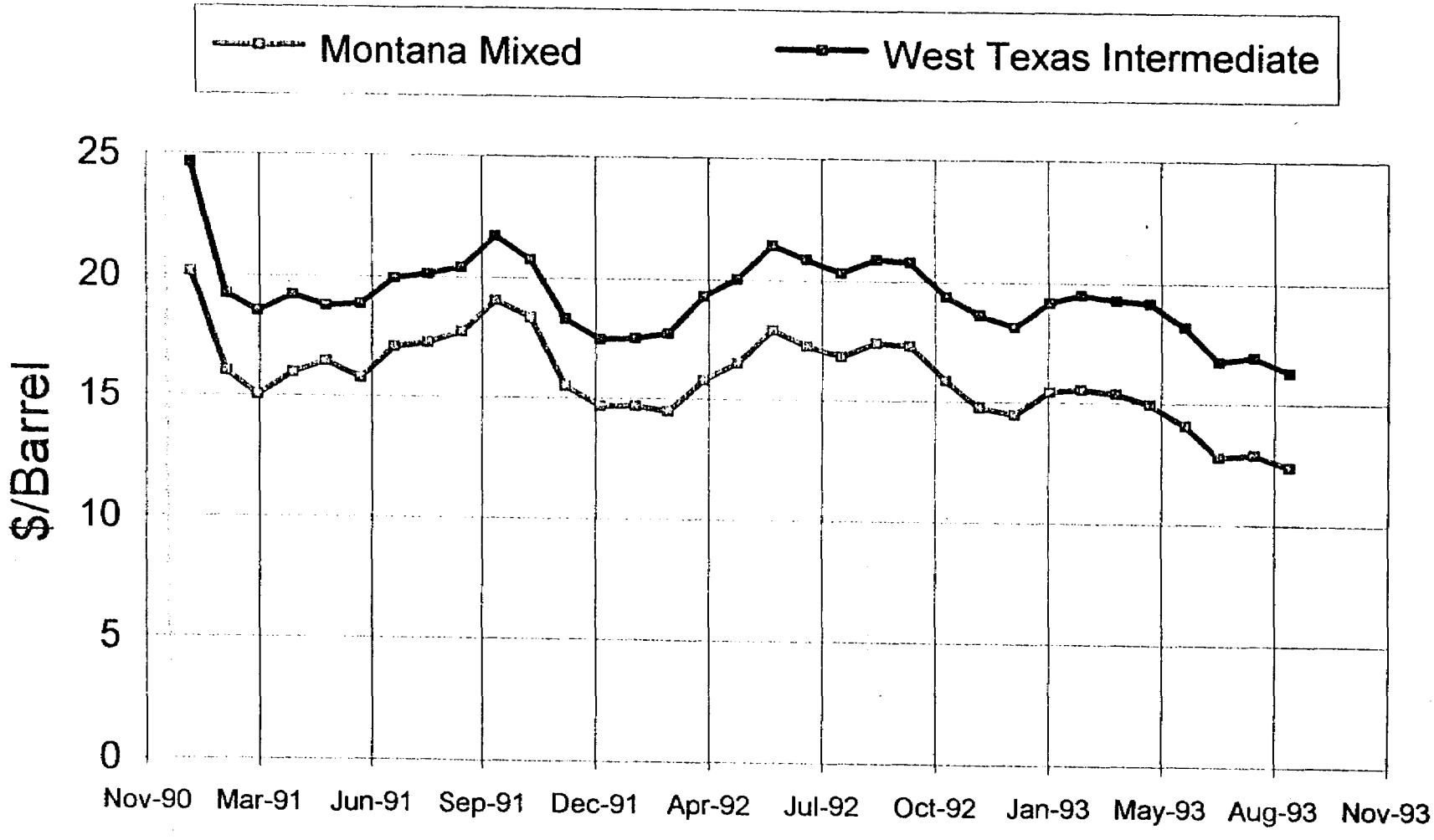
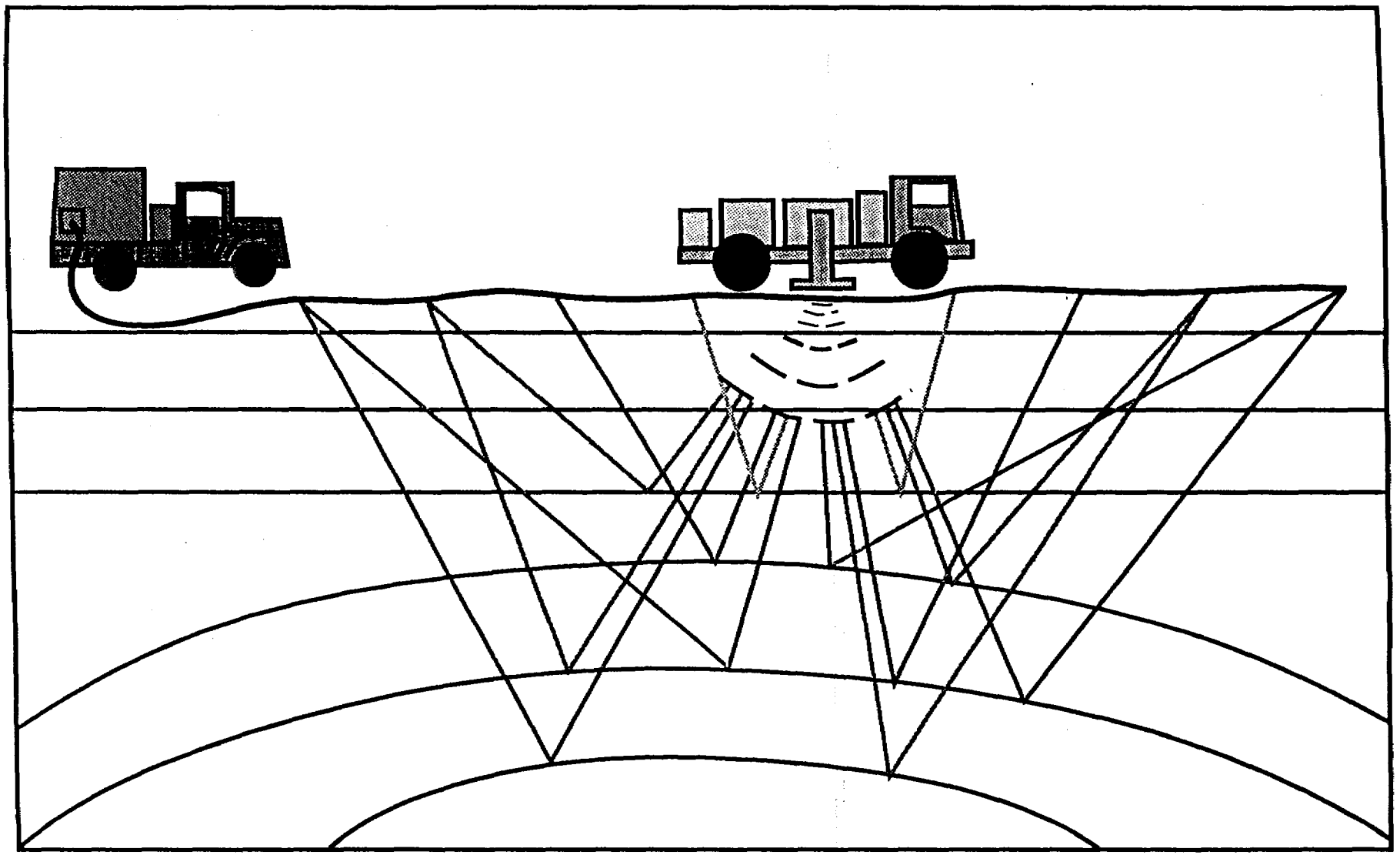
Crude Oil Prices



Seismic



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12-10-93
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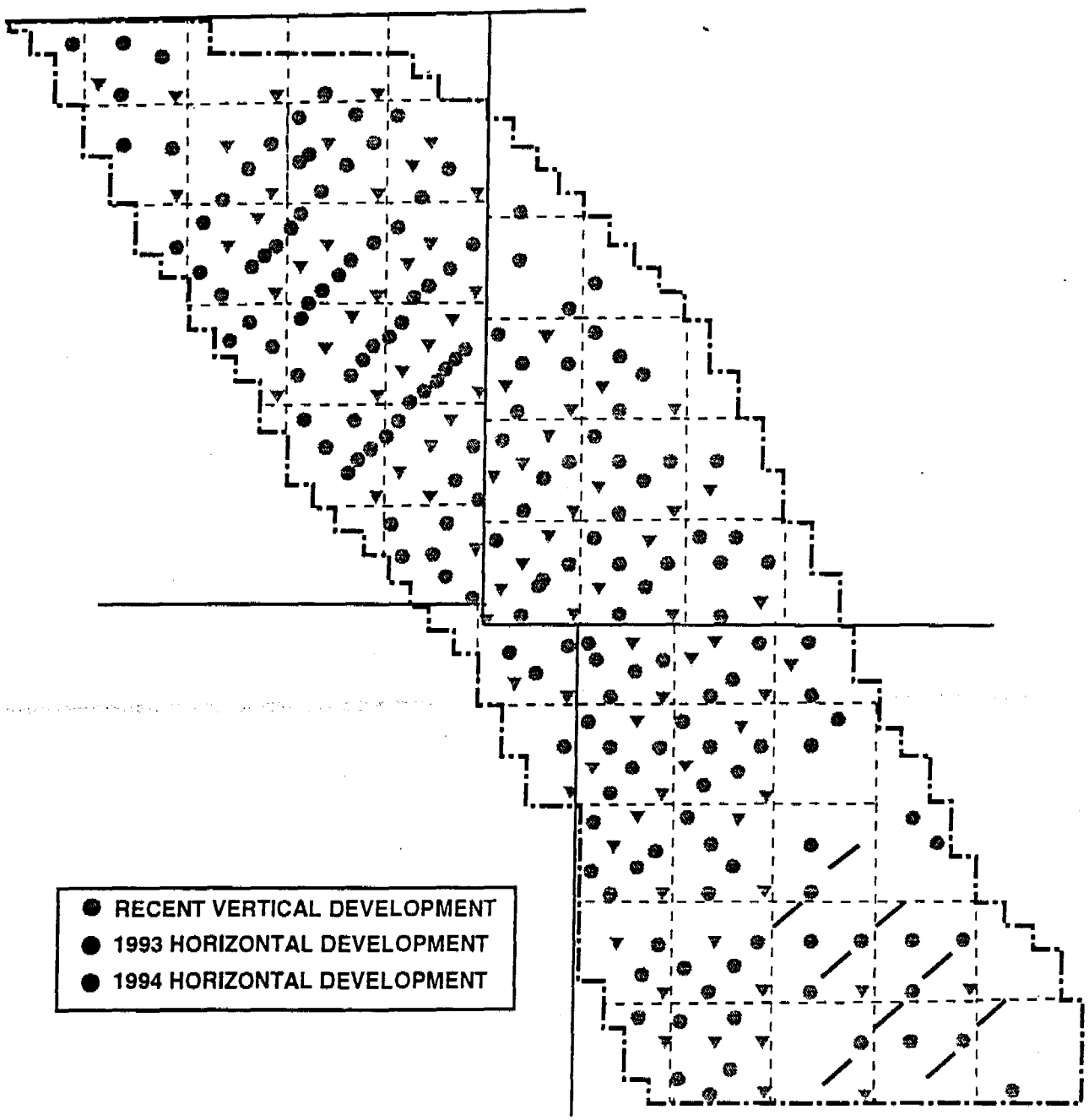
PENNEL WATERFLOOD UNIT

MAJOR DEVELOPMENT PROGRAMS POST 1986



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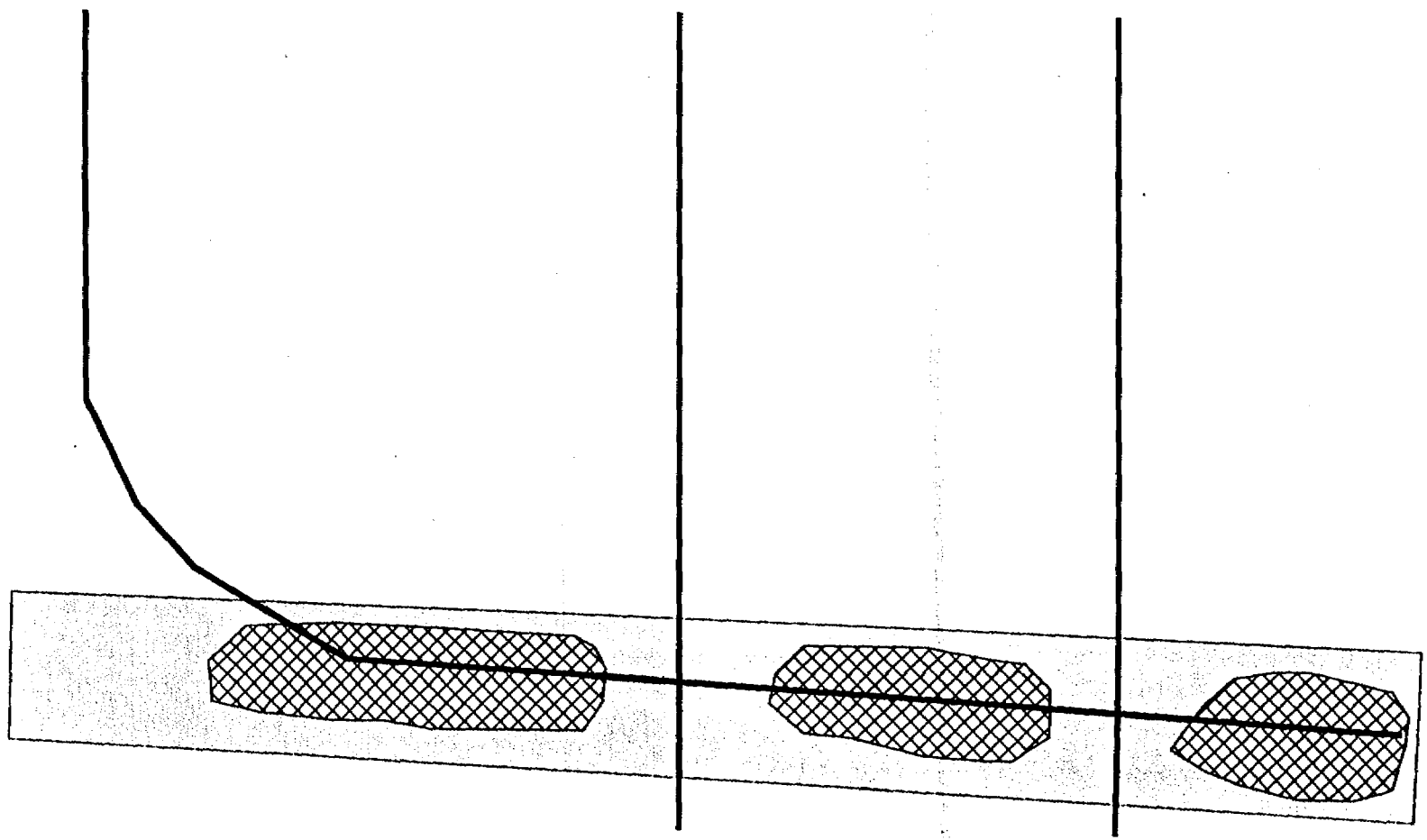
CEDAR CREEK ANTICLINE

HORIZONTAL WELL METHODOLOGY



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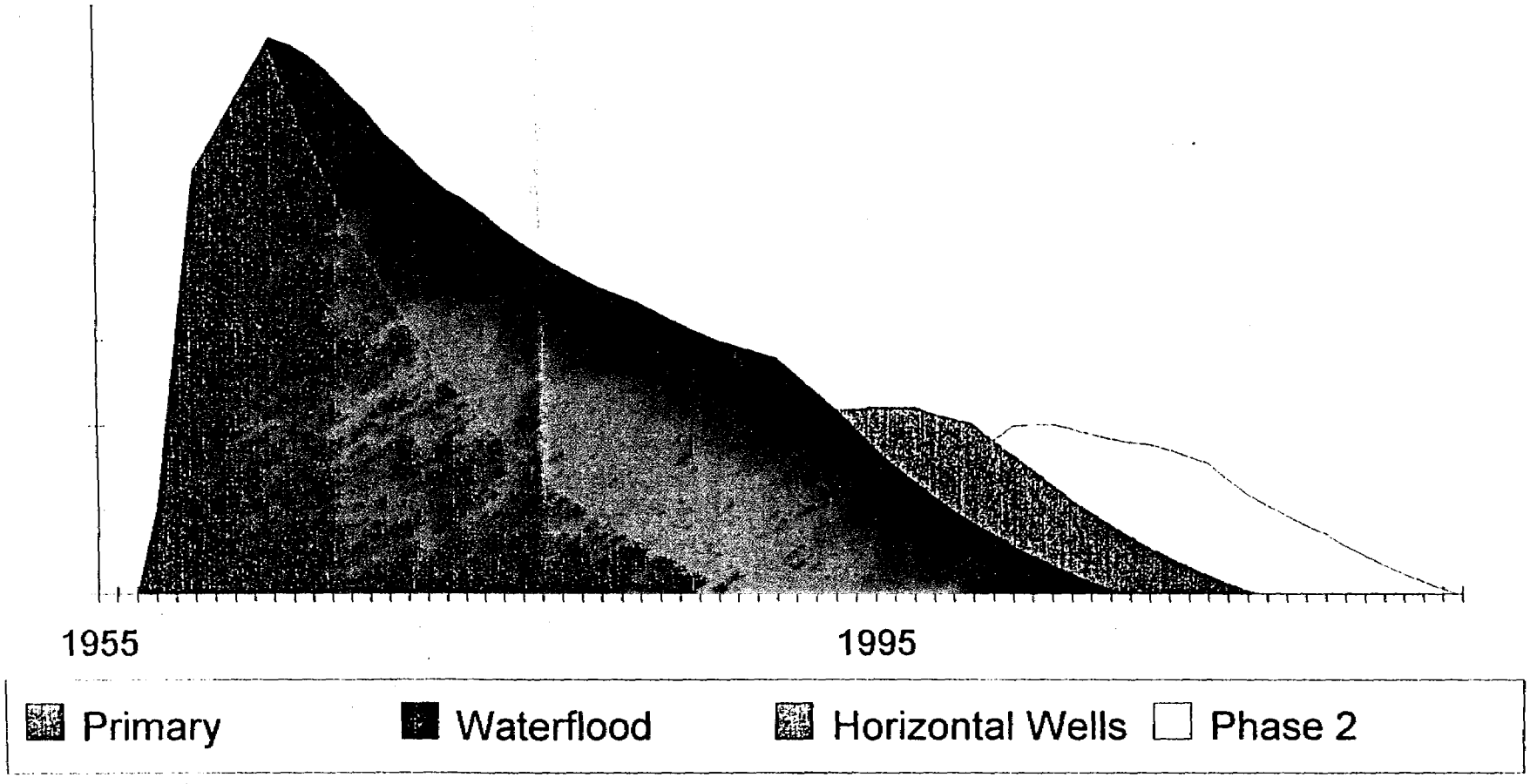
Cedar Creek Anticline
Impact of Horizontal Wells



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Project Profitability

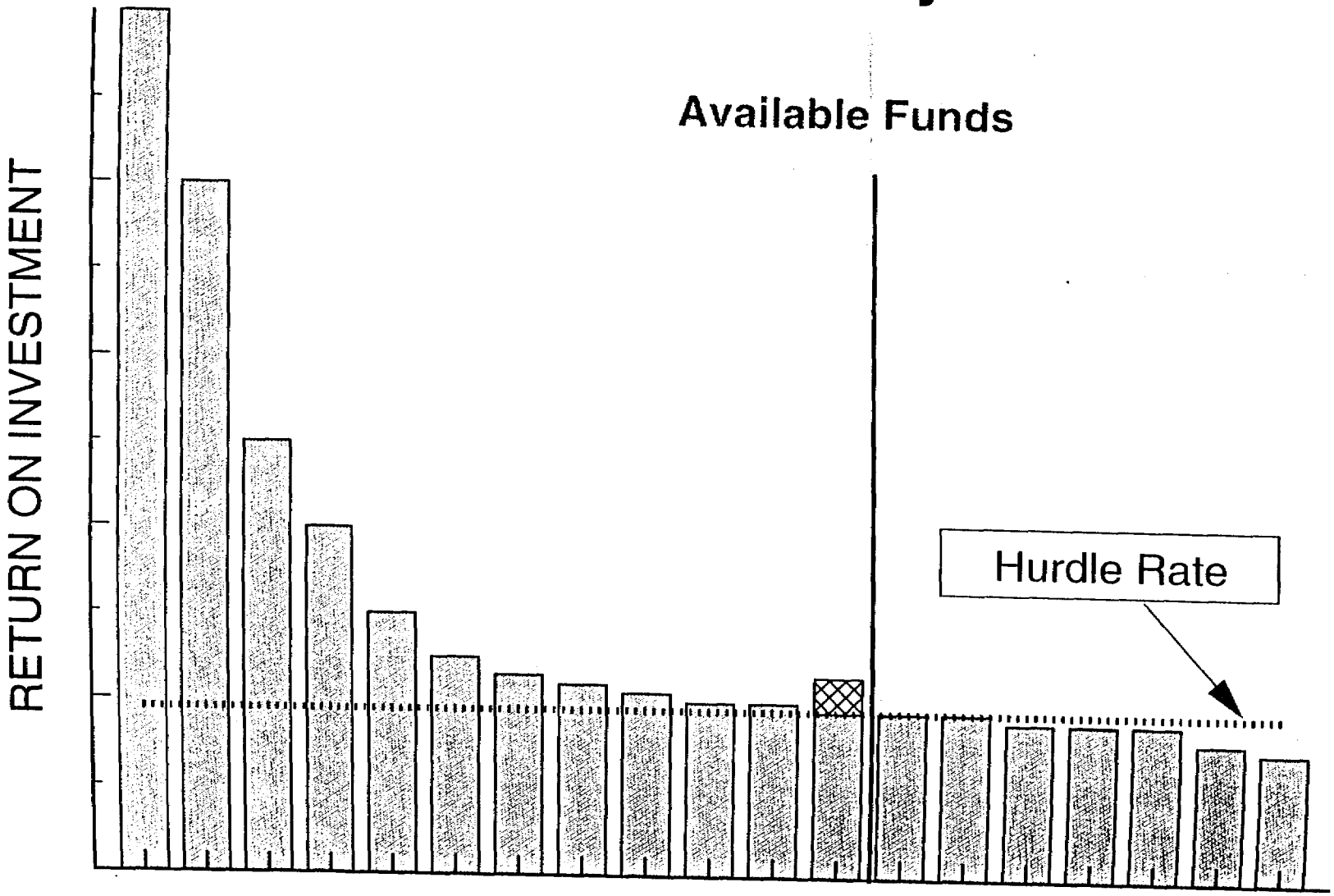

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EXHIBIT 4

EXHIBIT
DATE 12/10/93
SB 18

Texaco USA
Western E&P Region
Denver Producing Division

PO Box 46510
Denver CO 80201-6510
8055 E Tufts Avenue
Denver CO 80237
303 793 4000

December 9, 1993

The Honorable Bob Gilbert
Chairman
House Taxation Committee
Montana House of Representatives
State Capitol Building
Helena, MT 59620

Dear Chairman Gilbert:

Texaco Exploration and Production Inc. (TEPI) has horizontal oil wells in Blaine and Musselshell counties in Montana. We also have secondary recovery operations in Musselshell County. TEPI continues to review options for new horizontal drilling, secondary recovery and other oil and gas activities in Montana.

I strongly urge your support for incentives to encourage horizontal drilling and secondary recovery in your state. These are costly methods that can severely limit project profitability. The State of Montana's heavy tax burden on its oil and gas industry and high costs together put these projects in Montana at a disadvantage when compared to similar projects elsewhere. The proposed incentives would improve the chance that such high cost projects can return a profit in Montana. This, in turn, would improve the prospect of future drilling there. The incentives would only come into play, however, when a company committed to investing in these advanced methods in Montana.

In closing, TEPI encourages support for these incentives. They offer real benefits for companies that undertake such projects, and for the State of Montana and its people. Thank you for your review of this proposal and our thoughts on it.

Sincerely,

H. K. Parker

H. K. Parker
Assistant Division Manager

HKP:kdb

BALLARD & ASSOCIATES, INC.

December 7, 1993

Chairman Bob Gilbert,
Members House Taxation Committee

RE: SB18

Dear Chairman Gilbert and Members of the Committee:

I am writing to ask your support of SB18. This bill is an incentive to encourage the use of expensive, new technology to develop new oil and gas reserves in Montana. The bill in no way affects tax revenues on existing production, and in fact is a revenue enhancement bill in that it will insure development of new reserves and thus provide a new revenue stream to the State of Montana.

Incentives do work. Evidence of this exists in many other states as well as in Canadian Provinces to the north of our borders. They have worked in Montana, too. In 1987, when the legislature passed some incentive legislation, I pledged to the committee that my company would drill, or cause to be drilled, a minimum of 35 new wells in the State of Montana. In fact, we were responsible for 42 wells during the time that all the incentives existed. SB18 will result in many more than that.

Also, the Bill is important to independents because if passed, it will result in a test of new technology which could be applied to the same rocks in other areas of the State where drilling depths and costs are not so excessive. Fortunately, Shell and Meridian are willing to spend the money to test the procedures in the deeper, more expensive areas, thus providing access to reserves that for the most part are out of financial reach for smaller companies. However, if these companies prove that the technology works in certain formations where they are found at deeper depths, independents will then be able to take this technology to the shallow areas.

I strongly urge the committee to pass this bill and help provide Montanans with a new source or revenue.

Very truly yours,

W. W. Ballard

WWB:vks

W. W. Ballard

845 12th Street West / PO Box 20174
Billings, Montana 59104

12-10-93

SB 18

2000 POST OAK BOULEVARD / SUITE 100 / HOUSTON, TEXAS 77056-4400

CORPORATION

(713) 296-6000

December 9, 1993

The Honorable Bob Gilbert, Chairman
and the Members of the Committee
Montana House of Representatives
State House Taxation Committee
State Capitol Building
Capitol Station
Helena, Montana 59620

Dear Mr. Chairman and Members:

Please accept this letter as Apache Corporation's strong endorsement of SB 18 which provides tax incentives for increasing exploration and production in the State of Montana, especially those incentives dealing with horizontal drilling.

Apache Corporation has developed a significant position in Montana, and we hope to continue to expand. We have 29,000 acres under lease, and are participants in a horizontal well currently being completed. We are in the process of determining whether continued drilling and production make economic sense.

As you know, many states have come to the conclusion that increases in exploration and production for oil and gas are necessary to enhance the economy, to preserve jobs, and to protect their state treasuries. North Dakota, Texas, and Wyoming have already adopted incentive programs. Drilling and production incentives will be high on the agendas of the legislatures in Louisiana and Oklahoma. Tax incentives in those states have certainly encouraged more drilling and increased production.

However, SB 18 is unique in that it would encourage one of the most advanced of the high tech operations our industry has developed. This is precisely the kind of activity that states should encourage. Horizontal drilling can produce greater quantities of oil and gas in a shorter time in the most environmentally sensitive fashion because one horizontal well can replace many vertical wells.

More exploration and production means more revenue for the state and more jobs for Montanans. Encouraging horizontal drilling is exactly the right thing to do at exactly the right time. And in light of the recent dramatic drop in the world price of crude oil, incentives to spur more domestic exploration and production are even more crucial to the economic health of producing states and to our national security.

Again, Apache Corporation strongly supports the incentives for horizontal drilling that have been proposed. We urge you to move as quickly as possible to enact these incentives and to create more jobs and economic activity in the State of Montana.

Sincerely,

APACHE CORPORATION

Urban F. (Obie) O'Brien, III
Director, Governmental Affairs

UFO:ob/mhc

12-10-93
SB 18

W. M. VAUGHEY, JR.
P.O. BOX 46
HAVRE, MONTANA 59501-0046
(406) 265-5421

December 8, 1993

The Honorable Bob Gilbert, Chairman
House Taxation Committee
Montana State House of Representatives
Capitol Station
Helena, MT 59620

RE: In support of Senate Bill 18, the horizontal drilling-second and tertiary incentives initiative

Dear Bob:

It was my pleasure to testify before Senate Taxation December 2 in support of the above measure for the following reasons.

A small independent explorer for oil and gas in Montana the past 25 years and someone involved in the state legislative process since 1973, I am positive this measure will result during the next 18 months in a considerable amount of horizontal drilling that otherwise would not have taken place. Most of this will occur in extreme Eastern Montana. However, I think there's an excellent chance we will see some like drilling in both the Sweetgrass Arch area of our state and perhaps here in Northcentral Montana. The result will be increased oil production, which will in fact yield the state some badly needed increased tax revenues.

The fact that the Senate so overwhelmingly passed Senate Bill 18 December 6 argues strongly for the contention that this measure will work and make money for Montana. I have absolutely no selfish interest in the bill in the sense that the producing properties I'm fortunate enough to have an interest in do not lend themselves to horizontal drilling or second or tertiary procedures. Nevertheless, I'd be remiss if I didn't urge your Committee and the House as a whole to pass this measure.

Sincerely,

W. M. Vaughey, Jr.
Past President of the
Montana Petroleum Association

QUEST PETROLEUM CORPORATION
Corporate Pointe
5250 South Virginia Street, Suite 390
Reno, Nevada 89502
(702) 826-2700

November 30, 1993

Representative Bob Gilbert
Chairman, House Taxation Committee
Montana House of Representatives
State Capitol Building
Capitol Station
Helena, MT 59620

Dear Representative Gilbert:

Quest Petroleum Corporation is a small independent oil and gas producer operating in Montana and five other western states. In recent years we have drilled three horizontal wells in Montana and are considering drilling additional vertical and horizontal wells and reworking existing wells to improve production. However, as compared with other states where we operate, Montana costs - in particular taxes - are excessive.

Therefore, we would encourage you to support taxation legislation being considered during the Special Session to stimulate oil and gas investment in Montana. This is exactly the kind of incentive that would help influence Quest's decision to invest more in Montana.

If you would like to know more about our company and our experience in Montana, please call me at (702) 826-2700. Thank you for your support.

Very truly yours,

QUEST PETROLEUM CORPORATION

John V.A. Sharp, Ph.D.
President

JVAS:jen

TOTAL P.01

EXHIBIT 3
12-10-93
SB 18

CHOCTAW CORPORATION

December 10, 1993

Representative Bob Gilbert, Chairman
Montana House of Representatives
State Capitol Building
Capitol Station
Helena, Montana 59620

Dear Chairman Gilbert and House Committee Members:

Choctaw II Oil & Gas, Ltd. is a Texas limited partnership with Choctaw Corporation as its General Partner.

Choctaw currently operates 79 oil & gas wells in the Williston Basin, 45 of which are located in Montana. Additionally, Choctaw holds over 41,000 acres under lease in Montana.

Choctaw feels that horizontal exploration is the future of the basin and has considered commissioning a study for its application in the development of our leasehold acreage. However, as compared with other states where Choctaw operates, Montana costs -- especially taxes -- are excessive.

Therefore, I would encourage you to support legislation being considered during the Special Session to stimulate oil and gas investment in Montana. This is exactly the kind of incentive that would help influence my company's decision to invest more in Montana.

If you would like to know more about my company and our experience in Montana, please call me at (713) 546-8090. Thank you for your support.

Sincerely,

W. Russell Brown, Jr.
Senior Vice President

WRB:bk

EXHIBIT
DATE 12/10/93
SB 18

Western Environmental Trade Association

Aspen Court, 33 South Last Chance Gulch, Suite 2B
Helena, Montana 59601
Phone (406) 443-5541
Fax # 443-2439

TESTIMONY BEFORE THE

HOUSE COMMITTEE ON TAXATION

SB 18
TAX INCENTIVES FOR INCREMENTAL OIL PRODUCTION
FROM ENHANCED RECOVERY

DECEMBER 10, 1993

Mr. Chairman, Members of the Committee:

For the record, my name is Peggy Olson Trenk and I am the Executive Director of the Western Environmental Trade Association. I am here today on behalf of our membership to support SB 18.

Since our association reflects a broad spectrum of interests, we have the pleasure of working not only with the oil and gas industry, but with most of the other resource industries in Montana. Today, each of those is faced with a challenge to produce resources our society uses every day, but to do so in a manner that allows us to walk a little lighter on the land.

To achieve that, we are seeing all kinds of new partnerships being formed. Some bring various industries together, others involve regulatory agencies or environmental groups.

From our perspective, SB 18 is not so much about the state granting incentives to an industry as it is about the creation of a partnership. It is a partnership that encourages economic opportunity, allows us to produce a necessary product, and does so in a manner that incorporates the kind of technology that <u>does allow</u> us to walk lighter on the land.

As a result, we urge you to give your approval to this legislation. Thank you very much for the opportunity to offer testimony.

MONTANA PETROLEUM ASSOCIATION
A Division of the
Rocky Mountain Oil and Gas Association

EXHIBIT
DATE 12/10/93

33 S. Last Chance Gulch, Suite 2B
Post Office Box 1186
Helena, Montana 59624-1186

Telephone (406) 442-7582
FAX (406) 443-7291

Gail Abercrombie
Executive Director

STATEMENT IN SUPPORT OF SENATE BILL 18
before the House Taxation Committee
December 10, 1993

David A. Johnson
President
Montana Petroleum Association

My name is Dave Johnson, and I am here as President of the Montana Petroleum Association to speak in support of Senate Bill 18.

Our Association members are sensitive to the perception of bringing this incentive bill before you at this time of budget concerns. But we cannot change the realities of lead time these horizontal drilling and enhanced recovery projects need in vying for corporate dollars. This, coupled with the fact that the lower tax rates apply only to the incremental production increases resulting from enhanced recovery, leads us to support the introduction and passage of this incentive proposal during this special session.

Senate Bill 18 is not a "give away". It encourages our members to put money on the table -- in Montana -- to employ enhanced recovery technologies that can stem the decline of oil recovery from existing fields. It also encourages making the expenditures required for horizontal drilling projects that can yield greater recovery from primary production in existing and new fields. There is no benefit for producers until they put money into new projects that produce.

The benefit to Montana will be both economic and environmental. Montana Petroleum Association member Kurt Burris, president of Cardinal Drilling out of Billings, reports that horizontal drilling technologies are changing and improving every month. Over our northern border in Saskatchewan, where there has been more utilization of horizontal drilling, they have been running three to four laterals off of one bore hole. That means one drill pad for an extensive system of resource recovery. Less surface disturbance ... More recovery. Bill White, Deputy Secretary of the U. S. Department of Energy, recently cited a report that concluded that "new technology alone, at every reasonable price scenario, could boost recoverable [crude oil] discoveries by about 45 percent, and the use of advanced technology can have at least as much impact as price increases in terms of increasing resource recovery."

As Mr. Bill Ballard, president of Ballard and Associates in Billings, said in his letter to you, "Incentives do work. They have worked in Montana." He pledged to the 1987 legislature to drill 35 new wells in response to the passage of an incentive in that legislative session, and in fact, he was subsequently involved in the drilling of 42 wells.

In a letter to the White House, U.S. Senators from oil producing states, wrote "... we need to focus on preserving our domestic oil and gas industry..." and "by encouraging domestic exploration and drilling, we can keep ... dollars and the accompanying jobs, here at home." Senate Bill 18 is part of such a program.

The Montana Petroleum Association thanks Governor Racicot for including the drilling incentive in his call and thanks Senator Halligan for his leadership in sponsoring Senate Bill 18. We urge its passage as Montana's part in the encouragement of domestic drilling while preserving existing tax revenues and expanding the taxable production base in Montana.

EXHIBIT
DATE 12/10/93
SB 18

Amendments to Senate Bill No. 18
Third Reading Copy

Requested by DOR
For the Committee on Taxation

Prepared by Lee Heiman
December 9, 1993

1. Page 5, line 13.
Following: "production wells,"
Insert: "the recompletion of existing wells as horizontally completed wells,"

2. Page 5, line 14.
Following: "of"
Insert: "an"

3. Page 8, line 1
Strike: "natural gas,"
Following: "petroleum"
Strike: "."

4. Page 9, line 17.
Following: "new"
Insert: "production, production from horizontally completed wells,"

5. Page 9, line 19.
Page 11, lines 1 and 6.
Page 12, lines 16 and 17.
Page 13, lines 8 and 11.
Page 17, line 17.
Page 33, line 21.
Page 34, line 11.
Page 35, lines 16 and 24.
Page 36, lines 6 and 21.
Page 37, line 11.
Page 38, line 19.
Page 40, line 15.
Page 44, line 13.
Page 46, line 15.
Page 50, line 9.
Following: "production"
Insert: ", production from horizontally completed wells,"

6. Page 9, line 25.
Following: "oil"
Insert: ", production from horizontally completed wells,"

7. Page 12, line 2.
Following: "production"
Insert: ", for production from horizontally completed wells,"

8. Page 15, line 16.
Page 28, line 2.
Following: "DAYS"
Insert: "on which the price was reported"

9. Page 16, line 22.
Strike: "NEW PRODUCTION"
Insert: "Production"

10. Page 17, line 15.
Following: "of"
Insert: "taxes on"
Following: "new"
Insert: "production, production from horizontally completed wells,"

11. Page 17, line 16.
Strike: "taxes"

12. Page 32, line 3.
Following: "of"
Insert: "taxes levied on"
Following: "production"
Insert: ", production from horizontally completed wells,"

13. Page 32, line 4.
Strike: "taxes levied"

14. Page 32, line 20.
Following: "of"
Insert: "taxes levied on"

15. Page 32, line 21.
Following: "production"
Insert: ", production from horizontally completed wells,"
Strike: "taxes levied"

16. Page 33, line 20.
Following: "of"
Insert: "taxes levied on"

17. Page 33, line 22.
Strike: "taxes levied"

18. Page 34, line 10.
Following: "of"
Insert: "taxes levied on"

19. Page 34, line 11.
Strike: "taxes levied"

20. Page 35, line 15.
Following: "of"
Insert: "taxes levied on"

21. Page 35, line 16.
Strike: "taxes levied"

22. Page 35, line 23.
Following: "of"
Insert: "taxes levied on"

23. Page 35, line 25.
Strike: "taxes levied"

24. Page 36, line 5.
Following: "of"
Insert: "taxes levied on"

25. Page 36, line 7.
Strike: "taxes levied"

26. Page 36, line 21.
Following: "of"
Insert: "taxes levied on"

27. Page 36, line 22.
Strike: "taxes levied"

28. Page 37, line 10.
Following: "of"
Insert: "taxes levied on"

29. Page 37, line 11.
Strike: "taxes levied"

30. Page 38, line 18.
Following: "of"
Insert: "taxes levied on"

31. Page 38, line 19.
Strike: "taxes levied"

HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

SB 18

Natural Resources COMMITTEE BILL NO. HB 73

DATE 12/10/93 SPONSOR(S) Halligan Mohan

PLEASE PRINT **PLEASE PRINT** **PLEASE PRINT**

NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
JOHN PIGG 106 12TH AVE SW, SIDNEY, MT	H.R.P. OIL PROPERTIES	SB18		✓
Don Franz	Franz Constr Inc Box1046 Sidney MT.	SB18		✓
Don Regier	Fallon County Extension	SB18		✓
Del Kempton	Baker, Mont	SB18		✓
Sue M. Olson	MT Oil, Gas & Coal Counties Municipals City	SB18		✓
Michelle Lynch	MT Assoc Oil, Gas & Coal Cun.	SB18		✓
Rocky Gorder Sidney	B+G Restaurant Sidney MT	SB18		✓
Robert Marquiss	Updike Bros Inc. Sidney MT.	SB18		✓
DAVE CRAMER	DAVE'S HOT OIL SERV. SIDNEY MONT.	SB18		✓
DAVE JOHNSON	MT PETRO. ASSOC.	SB18		✓
Perry Pearce	Meridian Oil Inc	SB18		✓
GAIL ABERCROMBIE	MT Petroleum Assn	SB18		✓
JEROME ANDERSON	SHERWESTERN EXP INC.	SB18		✓

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

HOUSE TAXATION COMMITTEE BILL NO. SB 18

DATE 12/10/93 SPONSOR(S) HALLIGAN

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NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
DENNIS EVERSON	NORTHERN MONTANA OIL & GAS ASSOC.	SB 18		✓
STAN KALECZIC	MERIDIAN OIL	SB 18		✓
Bob Sheffield	Shell Oil	SB 18		✓
DAVE KASTEN	Self	SB 18		✓
JIM TUTWILER	MT Chamber	SB 18		✓
John Johnson	HD-23	SB 18		✓
Larry Tveit	SD 11	SB 18		✓
Joan Ebzery	Exxon	SB 18		✓
Ken Williams	Entech	SB 18		✓
Dennis Burr	MOSTAX	SB 18		✓
Bill Sullivan	Meridian Oil	SB 18		✓

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